

◆ INTERNATIONAL NOTE

MORE SMALL BUSINESS IS NOT THE ANSWER FOR PERU

Governments in Canada, Australia, the U.S., Singapore, and elsewhere have viewed the formation of small businesses and the encouragement of entrepreneurship as a solution to national economic stagnation, but the link between small business and the economic prosperity of a nation does not always hold true. Perhaps the best illustration to exemplify this is the case of Peru.

Many readers may associate Peru primarily with its history and architectural treasures such as the ancient city of Cuzco, capital of the Incan Empire for centuries. When the Europeans conquered Cuzco in 1533, it was one of the largest cities in the world, and one of the most important business centers in the Western Hemisphere. Half of Peru's population are descendants of the Incas, and research on Incan business practices reveals what may be the root of the socioeconomic problems that plague Peru today.

History

For millenia, small business has existed among most civilizations around the world. In our culture, the Bible describes early business transactions and trade between individuals. These were small in scale, but eventually led to the birth of large business in Europe. Ultimately small businesses gave rise to large firms, which in turn grew to become the multinational enterprises of today.

Small business, however, is a relatively new concept in South America. The Incas apparently had no small business

within each community. Rather than trade as individuals, they traded as groups between communities. Within each settlement, inhabitants shared what they had. The excess was collectively traded in exchange for other goods elsewhere.

Only with the arrival of the Europeans did the Incas learn about non-collective, one-to-one small business. The urbanized descendants of the Incas became increasingly intrigued with entrepreneurial values, and rejected the traditional communal approach. Among non-rural inhabitants, the novelty of small business and working for oneself, replaced the traditional style of communal business trading of the Incas. Since its independence in 1821, Peru has experienced an exponential increase in small business among the urban population. As a result, Peru now suffers from a number of small businesses well beyond the optimal as well as from a lack of sufficient numbers of large businesses and associated economies of scale.

These problems were aggravated by increasing urbanization. In April 1968, the Agrarian Land Reform expropriated large farms belonging to the few families which controlled the economy in an effort to redistribute wealth. Thriving plantations which had employed thousands of peasants were subdivided into many small lots for distribution to the masses. Yet many of the individuals working the land preferred working for wages than as

subsistence farmers working for themselves. They were given fertile farms for free, but they had no education—obligatory education was introduced only in 1974—nor start-up capital. Nor were economies of scale possible any longer. Field size could not justify the acquisition of machinery. Many rural workers left their fields to the weeds and moved to the cities, looking for jobs.

By 1970, one-third of the population had abandoned the land. Sugar, which was a major export until 1975, is now imported; the farms are feeding fewer people, and consumers are turning more to fish as an inexpensive food source. (Previously, tuna and mackerel were caught mostly for export, but are now in demand in the local market. Tuna and mackerel sell for 65 cents a kilo, whereas sea bass, flounder and beef all sell for around \$4 per kilo.)

Until 1965, the major export of Peru was guano from birds that nested along the shoreline which entrepreneurs sold as fertilizer. Now that fish are less plentiful due to increased local consumption, few birds remain along the Peruvian coast to feed on the depleted fish stock. The result is that there is no more bird dung for export.

The cities provide little opportunity for workers or entrepreneurs. Most Peruvian firms do not grow beyond family business size. In the U.S., small business provides many jobs, but this is not the case in Peru.

Government Efforts

With the influx of farm workers, the city of Lima became seriously overpopulated. Although immigration to the cities was stopped, unemployment skyrocketed, as did inflation. (During the first six months of 1987, prices soared by 150 percent.) Interest rates also rose (49 percent on savings accounts in July 1987). The government began to subsidize mortgage interest rates at 38 percent, and went as low as 29 percent for low-income earnings.

The country's deficit shot up, and people scrambled for foreign currency as the Peruvian sol (meaning "sun") tumbled. Hence, the joke that the "sun" is always descending in Peru. In 1985, in response to a deteriorating currency, 1,000 soles were revalued as 1 inti, the new unit of currency.

To strengthen the inti by reducing foreign debt, and to project jobs, the importation of automobiles into Peru was banned in 1986. The previous high duties of 150 percent had failed to discourage buyers. The economic elite tend to be entrepreneurial families, either well-established in business, or else in the government/military sector. For them, the 150 percent duty was not a real deterrent. Yet most ordinary citizens cannot afford automobiles. A Peruvian-made Volkswagen costs about 7,000 U.S. dollars. Fuel costs were recently increased from 80 cents per imperial gallon to \$1.20 per gallon, a high cost for the average citizen, since the minimum wage in 1987 was \$58 (U.S.) per month. Salaries for office workers were around \$300 monthly; university professors earned about \$12 per hour; and teachers earned about \$350 per month.

The social democrat government tries to redistribute wealth to low-wage earners through such means as the establishment of special stores which provide subsidized "family baskets" that contain essentials at a cost less than market price. Water is also subsidized, although indirectly.

In an attempt to combat 30 percent unemployment, the government also introduced retirement with 100 percent salary benefits at age 55 for women and age 60 for men.

Costs for such programs fall on the taxpayer; typically, the entrepreneur who has employees tends to pay a high price. Employers deduct 11.5 percent from all salaries for socialized medical coverage, and must add to that an additional 10.5 percent.

Many small business owner/managers in Peru tend not to declare all taxable revenues. As most people in the urbanized areas are self-employed, this poses a major revenue collection problem for the government.

Homeowners pay very high property taxes, but these are often based on self-evaluations of the worth of their property—with room for considerable intentional or unintentional error. However, upper-class districts have official evaluations. An example of such a neighborhood is Miraflores, where a home typically costs \$350,000. In striking contrast, rent in nearby downtown Lima is \$1 per month, with strict rent control. Landlords of rent-controlled buildings often prefer vacancies to tenants, since property taxes are usually higher than rents, unless leases are adjusted for devaluation against the U.S. dollar. Much of colonial Lima, therefore, is in a state of deterioration and disrepair.

The government is hoping that entrepreneurial talent may increase exports, improve the tax base, and provide property for all. Yet this does not appear

to be happening. Owner/managers often pay employees “under the table” and income tax is difficult to collect. The government encourages stores to remain open from 10:45 a.m. to 7:45 p.m., yet many shopkeepers prefer to have a siesta.

Conclusion

In countries with Western-style urbanized, industrialized economies such as the U.S., Canada, Australia, Singapore, and the European nations, the encouragement of small business may be one route to economic well-being. But students of international small business issues should be aware that not all settings can benefit from more small business. The example of Peru demonstrates how a nation may have an abundance of small business people, yet remain impoverished due to a multitude of other factors. Programs which have been successfully applied in one country may not work in another setting where cultural and governmental differences may require a much different approach.

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The *Journal of Small Business Management* initiated the “International Notes” feature in April of 1987 to provide an outlet for research notes and brief discussions relating to small business/entrepreneurship issues and developments outside the U.S. and Canada. (Full-length articles on world-wide business are also welcomed, particularly if they are based on original research.) International Notes submissions should not exceed six to eight double-spaced pages in length. Two copies should be submitted to: The Editors, *JSBM*, West Virginia University, P.O. Box 6025, Morgantown, West Virginia 26506-6025.