

**THE ROLE OF GOVERNMENT POLICIES TO
ENHANCE ENTREPRENEURSHIP THROUGH
BUSINESS - FRIENDLY ENVIRONMENT:**

IMPLICATIONS FOR PERU

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ABSTRACT

This Paper presents the results of a research on formal or informal entrepreneurs conducted in Peru. The research, based on secondary data, aims at understanding the impact of Government policies to enhance the entrepreneurship in Peru by providing business-friendly environment to develop their activities in Peru. The policies include dealing with the challenges when doing business such as accessing to financing, starting business, dealing with licenses, property rights, paying taxes, trading across borders and the strategies adopted to overcome these problems. Additionally, this research aims at evaluating the degree of informality of entrepreneurs in Lima and other provinces, by collecting information on whether and why they are officially registered, have the required licenses to operate, pay taxes and comply with the regulations for their employees. Finally, this work aims at reflecting on which policies, if any, could facilitate the development of all enterprises and increase their degree of formality.

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ABBREVIATIONS

ILD	Institute for Liberty & Democracy
SUNAT	National Superintendence of Tax Administration
RUC	Registro Único de Contribuyentes (Unified Business Register)
DBR	Doing Business Report
WB	World Bank
FDI	Foreign Direct Investment
CONFIEP	National Corporation of Private Business Institutions in Peru
CONITE	Commission of Investments and Foreign Technologies
COFIDE	Financial Corporation for Development
SNI	National Society of Industries
MIGA	Agreement with the Multilateral Investments Guarantee Agency
IPR	Investment Policy Review
APEC	Asia Pacific Economic Cooperation
ICT	Information and Communication Technology
GDP	Gross Domestic Product
MNC	Multinational Corporations
KBE	Knowledge Based Economy
UN	United Nations
FTA	Free Trade Agreement
UNCTAD	United Nations Conference on Trade & Development
Pro Inversion	Private Investment Promotion Agency Peru
IADB	International American Development Bank
MEF	Ministry of Economy and Finances
INEI	National Institute for Statistics and Informatics
IPAE	Peruvian Institute of Business Administration

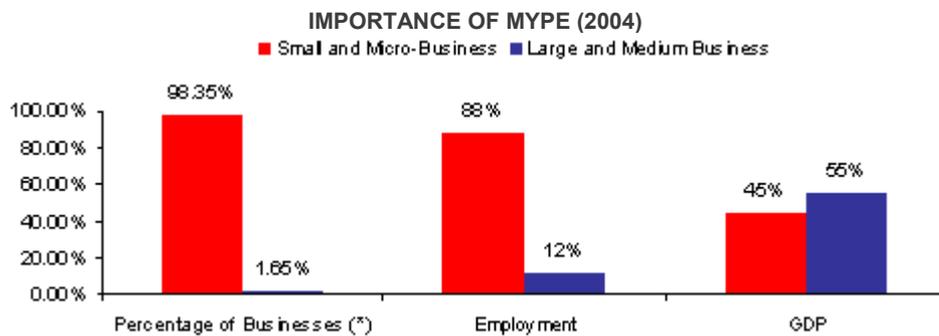
Chapter 1

Introduction

1.1 Setting of the Problem

This Paper presents that Peru has not consolidated to build an inclusive market economy through new policies that enhance doing business. According to important macroeconomics indicators, micro and small businesses have been playing an important role for the development of domestic economy (Figure. 1) but they have encountered barriers that prevent them from growing. Mypes¹ sector plays a key role in employment generation. For instance, in 2004 it contributed with 42 percent of Gross Domestic Product and generated 88 percent of private jobs (Pro- Inversion, 2004:93).

Figure.1 Important Role of Mypes in Peru



Source: Ministry of Job and Employment Promotion and Pro- Inversion, 2004:93

¹Mypes are SMEs known as Pymes in Peru. There are economic organizations of services or goods of a very limited scale. Nevertheless as a management business unit, it represents a huge impact for the Peruvian economy.

Despite the fact that the legal framework has pointed out the protection of domestic and foreign investors and the equality of market conditions for Mypes and big companies (called Large Enterprises) without any discrimination among them, the inefficient administrative system hampers the business-friendly environment.

According to Inter American Development Bank Report, the reality of the Mypes sector shows that the lack of execution of the Judiciary prevents informal business from becoming formal. Hence, this situation affects not only entrepreneurs but also slows the improvement of national economy (2003:1). The weaknesses of some public institutions should be considered as role of government policies that have not been developed in favor of Mypes.

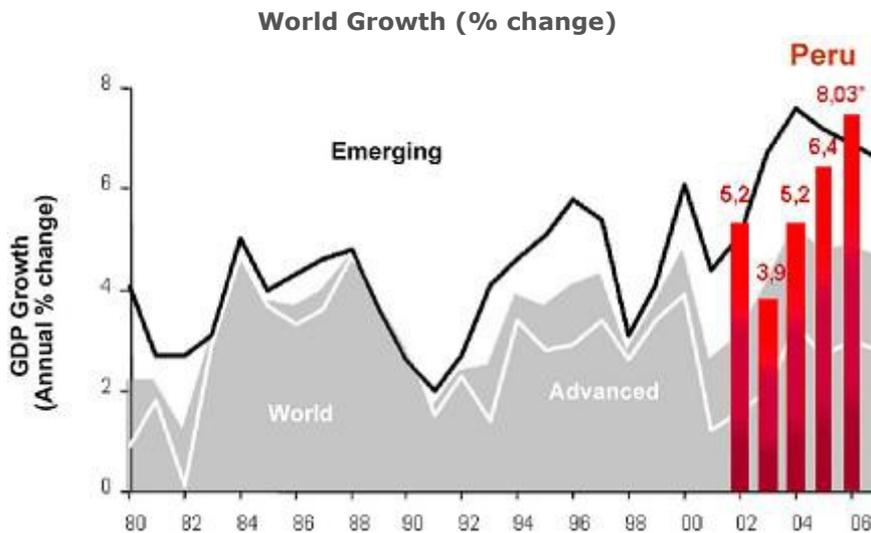
Therefore, the role of entrepreneurship has not been supported by new policies that boost regular investors² to set up and run their own business. “Peru have evolved not only offering to world its natural resources but also having shown a huge level of early stage of entrepreneur” by GEM (2006:15). The Peruvian State has never enunciated clear and consistent promotion of small businesses that would prioritize their role in the national economy through government policies to help small business to grow and develop. As a matter of fact, there are too many programs designed to support SMEs, but they have hardly ever progressed since all measures and interventions have led to reduce Mypes through these programs and made them less effective. Furthermore, the administrative system runs public goods oriented to Education, Job, and Health. These institutions are supervised by untrained people that can lead toward inefficient administrations, but if the government policies are not oriented to fix the administration system, for instance hiring the qualified staff with better salaries only for qualified professionals in

² Regular investors are people who set up business without a public national budget or without any budget given by foreign direct investment, especially transnational companies. People take risk in doing business in national geography and crossing borders in services or product sector.

order to prepare a strategic planning with issues to struggle against delays in the administration system. Thus, positive implications are expected to enhance business-friendly environment. Regarding Peruvian public administration system, it differs from OECD countries since high income economies possess the best and qualified people into their administrative system with high salaries. Moreover, OECD economies are concerned about providing a public health system that benefits everyone because they protect the human capital known as children, young or elder people precisely the last ones that have collaborated with their work for the development of these economies. (The Observer OECD, 2004:1)

Currently, there is a particular interest of Mypes since these firms come out to improve economic growth. Nevertheless, SMEs are not gaining all the recognition as a part of value chain but overall firms (Mypes and LE) show to have done well in economic growth (Figure. 2).

Figure.2 Economic Growth of Peru



Source: International Monetary Fund and Central Bank of Peru / Estimate: INEI. Prepared by: Pro- Inversion, 2007:1

“Exceeding even experts’ projections, exports reached US\$ (23.75) billion in 2006, and more than 35 percent in each one of the last three years. This reflects growth of international demand that can be rendered into higher international quotations and greater demanded volumes for Peruvian exports to the benefit of shrewd local business” (Pro- Inversion, 2007:1).

In the past, during the 1980s, due to the huge inflation, many people decided to go abroad in order to have a better future for their lives, whereas in 1990s, privatizations policies and the enhancing of the Tax System became a boom in those years but also many clerks lost their jobs due to employee reduction. As a result, employees became unemployed. Without a solution, many people decided to create their own company, but not all were able to succeed except a small portion that achieved a high standard of living. Forced by circumstances, some of these people became the new owners of the factories and others become owners of small businesses known as micro-entrepreneurs in the informal sector and created new jobs for the new generation. After that, many sectors of the economy went through a reform process, when Alberto Fujimori became President, in the beginning of 1990s. One of the first issues addressed by the new Administration was to provide a more appropriate legal framework for micro and small enterprises so that they could operate formally in order to boost the domestic market based on a “proposal made by the Peruvian economist Hernando De Soto’s think tank Instituto Libertad y Democracia (ILD)³. A Unified Business Register (Registro Único de Contribuyentes, RUC)⁴ was created to simplify the requirements and reduce the costs of conducting a formal business⁵. The

³ ILD Institute for Liberty and Democracy its President is Hernando de Soto known for his work of property rights.

⁴ The Unified Business Register has been absorbed into the National Superintendence of Tax Administration(SUNAT)

⁵ Formal Business means any enterprise that has RUC, or RUS (RUS-Exclusive simplified regime for individuals) and pays taxes to the SUNAT.

previously existing system of multiple registrations at different institutions, in fact, was considered one of the main causes of the high cost to formalize, and for that reason it was replaced by the Unified Business Register”. (Zuin, 2004: 1)

Currently, the opening of the markets through free trade agreement will allow everyone to compete in a globalized world that seeks the participation of all people as well as the main sectors of the society that focus on the issue of competitiveness, not only between companies but also nations.

According to the Global Entrepreneurship Monitor “study conducted by Babson College United States) and the London Business School (United Kingdom), Peru holds the first place among the most enterprising countries. Of each one hundred Peruvians, forty 43 percent are entrepreneurs, while the world-wide average is nine percent and the Latin American (the most enterprising region according to the same study) average is 16 percent”. Therefore, this study focuses on alternative perspectives highlighting the role of government policies that can enhance the capability of Mypes to succeed through doing business in Peru.

Due to the fact that Entrepreneurship have always received influence from aspects such as socioeconomic, political, cultural, and educational, the role of Government policies is important in order to boost entrepreneurial development. The relationship between Government and Entrepreneurship could have positive effects on the standard of living if they have a good connection with each other so as to benefit the creation of business- friendly environment in the country. However, the study suggests limitations (Doing Business Report 2007 -2008:6)⁶ because Mypes attempt to enhance the business environment without success.

Significance recognition has not reflected through the current legal framework which seeks financial and technological resources (Pro- Inversion, 2007:96). In

⁶ Doing Business Report is a business magazine prepared by World Bank. DBR measure all the countries in doing business.

fact, the Government recognizes that the role of entrepreneurship in the economic growth improves job creation and innovation not only in terms of free trade but also in economic development. Nevertheless, the delays in getting a license or unreasonable taxes do not allow these businesses to survive throughout time.

On the one hand, the 2008-2010 multiannual macroeconomics framework pointed out that economic growth will increase seven percent average based on domestic market, especially through investment and exports. On the other hand, the supplier responds with dynamism of non primary sectors such as industry and construction. A Strong fiscal position will lead the public debt coefficient reduction into the economy until twenty four point two percent toward 2010 year. The majority of this percentage goes directly to infrastructure works as well as social expenditures to fight poverty reduction in ten points and malnourishment in five points respectively. There are currently some changes in State reforms to improve social programs and the legal framework (Ministry of Finance and Economy, 2007:1). However, SMEs are not getting the full benefits of this situation and it seems that entrepreneurs are not making the most of it. The Government policies in this area are ineffective. There is a lack of coordination and a high tax burden, bureaucracy, and some kind of archaic Government regulations.

It is a fact that an efficient Judiciary is relevant to prevent entrepreneurs from recurring to solutions that affect their transactions, innovation, cost reductions, enlargement the companies and the finding of new partners to compete in the domestic market against big firms. Clearly, the reality of entrepreneurial activities is not gaining a fair position due to the lack of Government interest to fix the ineffectiveness of the mechanism in solving conflicts. As a result, negative impacts for Mypes are triggered.

Finally, this study seeks to examine the opportunities of implementing technical support to Mypes by qualified public and private institutions that already existed in the market but working isolated from each other. It is necessary to fix this situation so as to create confidence in these firms so that they can attend training institutions, receive updated information and have new business opportunities.

1.2 Research questions

Peru is encountering difficulties. Therefore the research questions are:

1. What should the Government do to enhance business policies to support entrepreneurship in Peru?
2. Are new Government policies required to improve entrepreneurship environment in order to achieve success through doing business in Peru?

The purpose of the research proposal is to understand and help key players known as entrepreneurs to manage any unexpected setbacks in order to successfully set up their own new enterprises or business⁷.

The study of this Thesis aims at enhancing better ways to extent the benefit of international development for entrepreneurs to succeed through business in Peru. However, the findings show that Government problems prevent entrepreneurs from developing competitively because they are still focusing on the comparative advantages of the country, based on natural resources. According to the IMD⁸, the competitiveness of doing business in 21st century will be linked for the next fifty years with many issues like , Foreign Direct Investment, labor cost, cheap brainpower, intense competition between value systems, China- India- Russia as Technological powers and so on (IMD,2007:63-65).

⁷ This classification considers the formal sector if the Government enhances policies that improve the business-friendly environment for everyone such as the micro- entrepreneur and successful entrepreneur.

⁸ International Institute for Management and development measures the competitiveness of nations through enterprises and people.

Therefore, competitiveness has become the mainstream in the world and doing business will be much more relevant in the future, but the Government has chosen to make improvements in the labor sector through attracting FDI in order to create more jobs rather than looking to enhance human capital through better education and training. Clearly FDI and Trade are important factors not only for job creation in Peruvian economy but also and more importantly to take advantages of technological transfer or new markets to exploit in benefit of strong national companies. In fact, doing business is affected by many things that are well shown in the Competitiveness Roadmap of IMD.

International commerce is a very interesting source to carry out business on a global scale, which is very profitable and allow the economic development of people around the world. Therefore, Entrepreneurs have to take the advantages of being globalized in different levels such as socioeconomic, political, cultural, and educational thus discuss the impact of entrepreneurship development through commerce.

1.3 Data

The method used is qualitative research, the sources of information coming from secondary data such as: books, journals, newspapers, magazines, and National institutions such as Ministry of Economy, Ministry of Production, Central Reserve Bank of Peru, SUNAT, Pro-Inversion, Conite and Private Institutions such as Confiep, National Society of Industries, Multilateral Investment Guarantee Agency, Doing Business Report, Global Entrepreneurship Monitor, World Economic Forum, JP Morgan Chase, Chambers of Commerce, Institute for Liberty and Democracy, APEC, Universidad de Lima, and so on. Therefore, collected information gives us a better assessment of the features of the domestic market as well as a description of current conditions of doing business.

1.4 Outline of the Study

The following section of this research is organized as follows: Section 2 summarizes the research, followed by revising arguments related to current policies and business-friendly environment. On Section 3, the role of the State is displayed in order to reanalyze business environment for entrepreneurship, understand why entrepreneurs are motivated and why they find barriers that discourage them from doing business in the national market. The implications for investment policies to promote entrepreneurship and the effect of Government policies, whether they need to be improved as well as the market conditions for entrepreneurs are explained in Section 4. Finally, on Section 5 includes current relations between Government policies and Entrepreneurship, followed by final comments and recommendations.

Chapter 2

Entrepreneurship and Small Business: a review of the literature

2.1 Definition of Entrepreneurship

“Austrian economist Joseph Schumpeter’s definition of entrepreneurship placed an emphasis on innovation, such as: New products, new production methods, new markets, and new forms of organization. The essence of Schumpeter’s theory of creative destruction is that entrepreneurs distort the market equilibrium by introducing new product market combinations or innovations. Sometimes, they use new technologies to do so. By innovating, entrepreneurs drive less productive firms out of the market and advance the production frontier. Innovation is therefore an important means by which entrepreneurial firms contribute to economic growth”. (GEM, 2007: 28)

Wealth is created when such innovation results in new demand. From this viewpoint, one can define the function of the entrepreneur as one of combining various input factors in an innovative manner to generate value to the customer with the hope that this value will exceed the cost of the input factors, thus generating superior returns that result in the creation of wealth.

As Kirzner asserts entrepreneurship is the ability to pursue new opportunities. This recognition and seizing of the opportunity will tend to correct the market and bring it back toward equilibrium (1973, 35).

The following Table.1 shows twofold entrepreneurship viewpoint from two scholars, Schumpeter and Kirzner.

Table.1 Typology of Entrepreneurship

Dimensions	Schumpeterian Entrepreneurship	Kirznerian Entrepreneurship
Economic Function	<i>Unbalancing Innovation</i>	<i>Equilibrating Coordination</i>
Analytical Context	<i>Business Cycles and Economic Development</i>	<i>Market Prices and Competition</i>
Analytical Content	<i>Historically-Specific Function in Economic Evolution</i>	<i>Universal Function in Market Processes</i>
Essential Activity	<i>Creation of Novelty</i>	<i>Discovery of Opportunities</i>
Essential Attributes	<i>Leadership Capabilities</i>	<i>Alertness and Market Knowledge</i>
Essential Domain	<i>Industrial Production</i>	<i>Market Exchange</i>
Objects of Activity	<i>Technological and Organizational Innovation</i>	<i>New Business Opportunities</i>
Source of Profit	<i>Innovation Rent</i>	<i>Price Arbitrage</i>
Stimulated Type of Change	<i>Discontinuous and Radical</i>	<i>Gradual and Incremental</i>
Impact on Agents and Structures	<i>Increasing Uncertainty by Creative Destruction</i>	<i>Decreasing Uncertainty by Market Completion</i>

Source: International Schumpeter Society Conference, 2004:6

As Schumpeter asserts, “one of the problems with firms having large resources endowment is that they may become less motivated to develop or seek new resources. Alternatively, **entrepreneurial** firms do so and thus create new resources or obtain and combine existing resources in unique ways to invent and innovate” (Hong, 2007 Lecture 2:8). Hence, they create imbalance in the market often reducing the value of established and stable firms’ existing knowledge along

with extensions of it. Lastly, creating new business required new knowledge. The literature acknowledges that new knowledge is relevant in these cases since business needs the new technology in order to learn how to use the new technology and effectively perform and compete in the new market.

Table.2 Entrepreneurship

	Schumpeterian Entrepreneurship	Kirznerian Entrepreneurship
Entrepreneurial Function	- Innovation: Creation and Leadership	- Coordination: Discovery and Alertness
Impact on Techno- Economic Paradigm	-Expansion of Production Possibilities; Creation of Novelty - Destabilization of Established Techno-Economic Paradigm - Generation of New Techno-Economic Paradigm	- Exploration of Production Possibilities; Discovery of Opportunities - Exhaustion of Established Techno-Economic Paradigm - Stabilization of New Techno-Economic Paradigm

Source: International Schumpeter Society Conference, 2004:13

According to JJ Servan-Schreiber, “the innovator has an idea about a product or service, and believes that nobody else had it before. In addition, the innovative Entrepreneur prefers if his/her idea has been tested elsewhere. Imitating do not bothers him/her. He focuses its research on the most successful in originality”. (1991:13). Further, to address the uncertainties and risk of the employer's motion requires a more vital energy, more durable and more original than the ambition of

power or the attraction: the pleasure of freedom. That means someone who does not have a Boss. This is for many the crucial interest of being entrepreneur. (Servan-Schreiber, 1991:19)

Drucker's ideas "It is an act of innovation that involves endowing existing resources with new wealth – producing capacity".

On the contrary, Mosakowski's chapter "clarifies how *entrepreneurs defeat an inherent resource disadvantage to generate wealth*. She also argues that companies with huge resources endowments experience problems such as core rigidities, reduced experimentation, lesser incentives to increase new resources and improved strategic transparency to rivals. As a result *entrepreneurs* are looking for new resources or creating them in order to generate wealth. Due to having lower resources they experiment how to get more have greater incentives to act as well as less transparent to potential rivals. In other words, less transparency prevent that rivals can understand and imitate these *entrepreneurial* and strategic actions."(Thornton, 1999)

Universities teach students to be managers, but there are not schools for being *Entrepreneurs*. It means there are self-taught students who become excellent businesspeople, whereas others are excellent students who fail as businesspeople.

2.2 Entrepreneurship vs. small business

In Peru, Mypes have traditionally been the main performers in domestic economic activities particularly as a large supplier of employment opportunities, as well as a creator of primary and secondary income sources for most households. The role of Mypes has been partially recognized since Fujimori's Administration and many economy sectors underwent a reform process. One of the first issues addressed by

the new Administration was to provide a more adequate legal framework for micro and small enterprises to operate formally in order to boost the domestic market thus creating synergy between Large Enterprises and Small - Medium Sized Enterprises. Following “a proposal made by the Peruvian economist Hernando de Soto’s think tank Instituto Libertad y Democracia (ILD)⁹, a Unified Business Register (Registro Único de Contribuyentes, RUC)¹⁰ was established with the aim of simplifying the requirements and reducing the costs of conducting a formal business¹¹” (Zuin, 2004:11). Nevertheless, the relationship among Mypes and Public Institutions were deteriorating until entrepreneurs understood those institutions have never helped facilitating business-doing. The former regime created burdensome in the administration system that affects Mypes and LE (Large Enterprises). The 2008-2010 Multiannual Macroeconomics framework pointed out that economic growth will increase seven percent average boosted by the domestic market especially through investment and exports. Therefore, the role of Mypes in supporting industries, producing components or consulting services for Large Enterprises via subcontracting systems or outsourcing is crucial and that will be reflected in the economic growth and GDP. Yet, these reforms have not provided development on large and small, domestic and foreign, urban and rural businesses. Another important factor is to analyze the misconception of small business and entrepreneurs. In an early study conducted in 2005, Schumpeter’s ideas “*suggested that many people use the terms **entrepreneur and small business owner** synonymously. While they may have much in common, there are significant differences between the entrepreneurial venture and the*

⁹ ILD Institute for Liberty and Democracy led by Hernando de Soto known for his work of property rights.

¹⁰ The Unified Business Register has been absorbed into the National Superintendence of Tax Administration (SUNAT). Currently there is another one RUS (RUS-Exclusive simplified regime for individuals)

¹¹ Formal Business means any enterprise that has RUC or RUS and pays taxes to the SUNAT.

small business. Entrepreneurial ventures differ from small businesses in these ways:

1. Amount of wealth creation - rather than simply generating an income stream that replaces traditional employment, a successful entrepreneurial venture creates substantial wealth, typically in excess of several million dollars of profit.
2. Speed of wealth creation - while a successful small business can generate several million dollars of profit over a lifetime, entrepreneurial wealth creation often is rapid; for example, within five years.
3. Risk - the risk of an entrepreneurial venture must be high; otherwise, with the incentive of sure profits many entrepreneurs would be pursuing the idea and the opportunity no longer would exist.
4. Innovation - entrepreneurship often involves substantial innovation beyond what a small business might exhibit. This innovation gives the venture the competitive advantage that results in wealth creation. The innovation may be in the product or service itself or in the business processes used to deliver it”.

According to Matsushita, “the decision of an entrepreneur is extremely important. Sometimes, the very existence of the company depends on its decision. Hence, the pressure and anxiety caused his responsibility. However, being in a position that requires a very serious responsibility may be in a certain sense, a pleasure to live. An entrepreneur must know how to judge the opportunity to take bold or prudent steps. This is the decision for being an entrepreneur. In any job or business, fit people stay fit and unfit people go to another place where they can enhance their ability and succeed”. (Matsushita, 1983: 74-5)

The micro and small enterprises known as MYPES are businesses constituted in Peru that fulfill requirement with respect to the number of employees and annual

sales level. The following Table.1 explains the difference between Micro and Small Business:

Table.3 Micro and Small Business

Business	Total number of employees	Annual Sales Level
Micro	From one (1) to ten (10) employees inclusive	Up to a maximum amount of 150 Tax Units–UIT ¹² (up to S/. 510,000 or US \$ 150,000)
Small	From one (1) to fifty (50) employees inclusive	From 150 UIT to 850 UIT (From S/. 510,000 to S/. 2,890,000) or (From US \$ 150,000 to US \$ 850,000)

Source: Pro- Inversion- 2004:93

The word entrepreneurship has a broad variety of meanings which can apply to the case of countries such as Peru. By definition, “an entrepreneur is a person of very high aptitude who pioneers change, with characteristics found in only a very small portion of the inhabitants. However, anyone who wants to run his or her own business is considering as an entrepreneur. Limited market environment and lack of Government policies hampers individuals’ entrance entailing high market entrance risk”. Consequently, the necessity makes you become entrepreneur in Peru. The necessity of who wants a better future for them and for their family, in terms of education, shelter, health conditions, clothes, etc. The entrepreneurs seek clients seeking good service with customer service or product with decent quality or cheaper price.

Normally, “Mypes account in Peruvian economy for more than ninety eight percent of all firms outside traditional sectors in the country, (e.g. seven six point eight percent services and commerce sixteen percent). Moreover, Mypes’ features represent an important engine for exports in their role of developing inter-

¹² Tax Mandatory Unit known as in Spanish Unidad Impositiva Tributaria (UIT).

industry linkages. Mypes do not export directly but do so indirectly by supplying other exporters". (Pro- Inversion, 2004:93)

2.3 Impact of Political Facts on Economic Growth

The Peruvian economy is based on exploitation, processing and export of natural resources, particularly mineral, agricultural and fishery, although in recent years there has been a significant and diverse remarkable growth in light industries and services. (Brown, 1996:105) To understand how Peruvian economic growth is developed, it is relevant to remark some political events that trigger economic setbacks.

Over the years, the economic situation of Peru has gone through many changes. According to Peruvian History from 1968–1975 military government of Juan Velasco Alvarado¹³ introduced “radical reforms such as agrarian reform, the expropriation of foreign companies, the introduction of an economic planning system, and the creation of a large state-owned sector. Neither of these measures achieved their objectives of wealth distribution¹⁴ and the end of economic dependence in developed nations. In 1980s, Alan Garcia left the country with hyperinflation, isolated from the international financial community, hyperinflation reached 7,649 percent in 1990 and had a cumulative total of 2,200,200 percent over the five years, thereby profoundly destabilizing the Peruvian economy with negative reserves of US\$ nine hundred million, continuous subversive activities by the Shining Path¹⁵”(Andrade et al.1987:84-7) , great increase in poverty levels and a multi-million and unfinished electric-train investment in Lima. “This issue

¹³He was a left-leaning Peruvian General who ruled Peru under the title of "President of the Revolutionary Government."

¹⁴ It is a comparison of the wealth of various members or groups in a society, and it is one aspect of the economy and social structure.

¹⁵ Terrorist group in Spanish known as Sendero Luminoso

also had effects on many companies that went bankrupt. Owners were forced to close their firms whereas others started their own small businesses in 1980's. He is said to have made poor decisions during his Administration and created an environment that lead to the rise of an authoritarian leader such as Alberto Fujimori”(Vargas- Llosa, 1993: 94). Some suspect Garcia and APRA¹⁶ made a deal with Fujimori during the 1990 election, backing him in return for immunity and prevent well-known writer Mario Vargas Llosa and his FREDEMO¹⁷ party from leading in the polls and coming to power (Vargas- Llosa, 1993: 96). During the campaign, Vargas Llosa promised to investigate corruption in the Garcia administration. Nevertheless, with these setbacks, the majority of the reforms were not changed until the 1990s, when the liberalizing Government of Alberto Fujimori ended price controls, protectionism, social assistance to the lower class people¹⁸, restrictions on foreign direct investment, and most state ownership of companies. “In 1990s, Peru was experiencing one of the worst crisis of its political, social, and economic history” (Vargas-Llosa, 1993:451-52). President Fujimori applied a shock policy which at first resulted in consumption reduction and production cut-back. Reforms were then implemented such as a vast program to restructure the State, privatize State-owned enterprises, cut subsidies, open up the market, fight tax evasion, thus creating a clear neo-liberal policy. Fujimori also reinserted Peru in the international financing system and Peru became eligible again for loans from the World Bank, Multilateral Agencies and Commercial Banks. Inflation began to drop dramatically (less than three per year) and the economic recuperation began. Meanwhile, people who had decided to emigrate for new horizons abroad changed their minds and returned to Peru and stayed in the country despite terrorism and recession. Loads of *entrepreneurs*

¹⁶ Political party in Spanish known as Partido Aprista Peruano

¹⁷ Political Party in Spanish known as Frente Democratico

¹⁸ Terminology used to identify poor people in the country.

arose. Congress was later dissolved on April 5, 1992, and a Constituent Congress was elected to approve the text of a new Constitution to be submitted to a referendum. The new Constitution has the clear objective of redefining the balance of powers established in the Constitution of 1979. This Constitution points out market social economy¹⁹. Good examples are Germany, Spain and Chile in South America. The Republic of Peru is democratic, social, independent and sovereign. Afterwards, the Political Constitution of Peru was approved by the Congress, ratified by the vote of Peruvians in a referendum held on October 31, 1993 and consequently promulgated by the Executive on December 29, 1993 (Brown, 1996:84-95).

Reforms have permitted sustained economic growth since 1993, except for a slump after the 1997 Asian financial crisis. Fujimori was reelected President in 1995. He defeated former UN Secretary of UN²⁰ Javier Perez de Cuellar²¹, in response to his successful economic reforms and his pacification strategy. During his second term, the panorama abruptly changed due to the hostage situation led by MRTA²² at the Residence of Japanese Ambassador²³. Meanwhile, the economic recession, Government corruption led by Vladimiro Montesinos and the struggle against the Constitutional Tribunal who opposed a third term for Fujimori were some of the period highlights. Probably victory would not have been possible without the dismantling of the Shining Path and the MRTA, both always linked to Narcotics.

New century, 2000 is characterized by the country's instability, for instance, dodgy elections, discovery of corruption among some congressmen and some

¹⁹The State leads the economy in the country so that can benefit the majority of the population, giving opportunities to everyone to participate in the market.

²⁰ United Nations

²¹ He is a Peruvian diplomat who served as the fifth Secretary-General of the United Nations from January 1, 1982 to December 31, 1991.

²² Terrorist's group in Spanish known as Movimiento Revolucionario Tupac Amaru.

²³ Terrorist's group in Spanish known as Movimiento Revolucionario Tupac Amaru.

businessmen, topped by Fujimori's escape to Japan and his distance resignation. For instance, in the 2000 elections, Fujimori was reelected again as President but the elections were questioned. In October 2000, Fujimori resigned as President of Peru and new elections were held without his participation. After those facts, the transition process led by interim President Valentin Paniagua aimed at enhancing the image of the Public System and Military forces and focusing on the preparation of the 2001 New Elections. Moreover, Paniagua's Administration decided to make exploration contracts in Camisea: a huge project of natural gas which forgotten in 1980s due to lack of vision of the former President.

“The advantages of Camisea's Natural gas have been used for industrial processes because it easily replaces several other types of fuel, including diesel, residual fuels, liquid petroleum gas (LPG), kerosene, coal and fuel wood. It can be used in various industries, like metal metals melting, cement, ceramics, glass, food, textiles, but most of all for electricity generation, where it is a cheaper source of energy and has an environmental reduction impact. It is also fundamental for the petrochemical industry”. (Inter American development Bank, 2008). The next president, Alejandro Toledo allowed economy to grow although the middle and lower classes in Peru still suffered in terms of microeconomics. Alejandro Toledo was elected President with more than 50 percent of the votes, followed by Alan Garcia, with more than 45 percent of the votes. In Toledo's Administration, the 2001-2006 economic policy was successful and achieved 10.01 percent accumulated inflation, international reserves of more than US\$ 17 million. (Central Reserve Bank of Peru, 2007:1)

Presidential elections were held in April 2006 and Alan Garcia won with more than fifty three percent of the votes and in second place, Ollanta Humala with more than 46 percent of the votes. (INEI 2007)

In the past, the country was marked by Government intervention, terrorism, and hyperinflation and Alberto Fujimori took the necessary steps to maintain those problems under control. Nevertheless, Democratic institutions are keeping a poor image so far, and particularly the judiciary. Despite those facts, the constant is that *entrepreneurs* still have problems to set up business due to the delay of burdening administrative process that need to be quickly reformed by the central government. Meanwhile, The Peruvian State dynamically promotes the attractiveness for both foreign and domestic investment in every single sector of the economy and many Peruvians are still waiting for a positive answer of the United States Government in terms of Free Trade Agreement negotiations that started in Toledo's period. Nevertheless, the issue became complicated, when at that time the United States Parliament had changed for electoral reasons. As a result, all papers and negotiations required the approval of the new parliament.

“Peru is a multicultural society with Ethnic Groups such as: Amerindian 45 percent, mestizo (mixed Amerindian and white) 37 percent, 15 percent, black, Japanese, Chinese, and other 3 percent”. (The Truth Commission, 2001:7) The Population is 28,368,758(Doing Business, 2007:1) citizens that speak different languages such as Spanish and Quechua²⁴, which are official languages, Aymara²⁵ and a large number of minor Amazonian languages. For those reasons, there is a big gap among the social levels. Thus, these differences among Peruvians cause problems of racism and human relations. Moreover, the poor and the rich are

²⁴ Is a Native American language of South America. It was already widely spoken across the Central Andes long before the time of the Incas, who adopted it as the official language of administration for their Empire, and is still spoken today in various regional forms (the so-called ‘dialects’) by some 10 million people through much of the South America, including Peru, southwestern and central Bolivia, southern Colombia and Ecuador, north-western Argentina and northern Chile.

²⁵ The Aymara are a native ethnic group in the Andes and Altiplano regions of South America; about 2.3 million live in Bolivia, Peru, Northern Chile, and Northwestern Argentina (in particular in Salta Province)

divided in social and economic status. Hence, the access to information is limited, only for those who can afford it while others face the culture of informality²⁶.

As a result, Alan Garcia became President, showing that his victory was granted by the fear of the population about Garcia's contender, who wanted to use many authoritarian measures like in the period of former President Velasco Alvarado back in the 1970s.(Andrade et al, 1987:84)

Garcia is now a moderate President and supports the negotiations to sign the US-Peru Free Trade Agreement. For our people, the accomplishment of the FTA represents new perspectives in terms of economic growth. Furthermore, due to the nature of the negotiations, the agreement is provided by chapters specializing in sensitive sectors such as agriculture, telecommunications, textile, among others, which contemplate differentiated schemes of tax relief and some reservations on the part of Peru and the United States. By definition, there are three sources from which Peruvian economists explain economic growth. "Two relate to the domestic market and the third to the external market. The first two come from the growth in domestic demand and the replacement of imports. Demand in the domestic market is satisfied with domestic production and / or imports. If the growth of this demand is accompanied with a slower growth of imports, then growth in the participation of national production in supplying the domestic market: this phenomenon is known as *import substitution*. If the opposite occurs, the foreign production shifts to domestic production and it loses domestic market. The third source is the export growth in excess of GDP growth, which is reflected on an increase in the penetration of our products into foreign markets".

²⁶ Meant that in the country exists informal firms that create doing business illegally. Almost the 90% of Peruvians firms are informal.

“Among the results at the closing of 2006, highlight areas such as construction 14.8 percent, commerce 12.3 percent, agriculture 7.2 percent, manufacturing 6.9 percent and other services 7.2 percent”. (Pro-inversion, 2007:37)

Recent economic growth has been fueled by macroeconomic stability, improved terms of trade, rising investment and consumption. Trade is expected to increase further after the implementation of US-Peru FTA, which awaits ratification by the US Congress. Furthermore, Peru’s main exports are copper, gold, zinc, textiles, and fish meal. Its major trade partners are the United States, China, and Chile (Pro-inversion, 2007:12). Peruvian economy is represented in industries such as mining and refining of minerals; steel, metal fabrication,; petroleum extraction and refining, natural gas; fishing and fish processing, textiles, clothing, food processing.(Brown, 1996: 105-18)

“Peru posses an extensive, astonishing territory with variety advantageously located in central South America, at one of the largest oceans on Earth. The Amazon River passes through the Amazon Rainforest, Brazil and the Atlantic Ocean. The Andes Mountains link Peru with Bolivia, Venezuela, Chile, Ecuador, Argentina and Colombia, through routes leading to the legendary Incan trails. Moreover, the Pacific Ocean allows Peru to connect with other members of APEC. Peru is a member of one of the most important, wealthy, and growing markets in the world”. (Pro-Inversion, 2007:36).

Peru is a country that has virtually all climates and relies on its outstanding nature, mining and power resources. According to Private Investment Promotion Agency²⁷ “Peru's natural advantages made it the leading exporter of asparagus and

²⁷ Private Investment Promotion Agency - PROINVERSION is in charge of elaborating, proposing and executing the national policy on the treatment of private investment, according to the economic plans and the integration policy. Besides, PROINVERSION registers foreign investment; handles and subscribes legal stability agreements that are established under the L.D. N° 662 y N° 757; and investment contracts in the frame of the Regime of Anticipated Recovery of the Value Added Tax. It also promotes private investment in utilities and public infrastructure; as well as in State assets, projects and companies. In the same way, PROINVERSION presides over

paprika worldwide; the leading producer of fish meal and oil fish; the leading producer of Alpaca and Vicuña fibers; the leading producer of silver worldwide, an up-and-coming net hydrocarbon exporter. Furthermore, in Latin America, Peru is the leading producer of gold, zinc, tin and lead; second in copper, besides other metals. In South America, Peru is the third largest country, second largest in areas of natural forests and one of the leading textile exporters (with high value items). It has great diversification in its exports as well as large biological richness and variety". (Pro-Inversion, 2006:7)

Chapter 3

Reanalyzing the Market Environment for Entrepreneurship

the commission for the negotiations of international investment agreements.

3.1 State: The Promotion Role for Mypes

In the market, today and tomorrow, businesspeople occupy a privileged place because *financiers* are looking to entrust their capitals, the **State** expects growth, innovation and employment, and *Employees* expect Mypes to run businesses efficiently.

The globalization of the international economy and the new macro-economic conditions prevailing at the national level have led to the national authorities to consider the necessity to strengthen the sector, through the establishment of a modern legal framework to allow for mechanisms and incentives to ensure the integral and sustainable development of small and micro-enterprise in the medium and long term, thus seeking to encourage private investment, employment generation, increasing competitiveness and productivity for enterprises, while encouraging the formalization and management training, among other fields. At a meeting sponsored by SELA and the Rio Group on Democratic Governance and Human Development in Latin American and Caribbean, it pointed out to overcome poverty and social exclusion through the achievement of actions that *“include internally sustainable macro and micro-economic policies and good administration of public resources and externally a greater opening of international markets so that parallel actions in these two areas generate growth, increase employment, lead to a better distribution of income, reduce external vulnerabilities and generate a permanent stimulus for productive investments”*. (2003:2).

It is popularly believed that economic agents are **State**, Entrepreneurs and workers. Hence, there is a new type of relationship between the **State** and Society, particularly regarding employment. It means opening new paths and forms of participation of various social actors, such as employers' organizations, trade

unions for workers, private banks, institutions dedicated to the formation and training of human resources, research and development, among others. It is accepted worldwide that the private sector - as development engine - significantly contribute to increased systematic competitiveness by reducing internal costs of production per unit of output and improvement in the quality, relying on the opening market at international level.

In the case of Peru, the national authorities have acknowledged that it is a priority to establish mechanisms and tools to ensure the business sector in order to increase access to domestic and international markets, so that we may assure its continued business development.

The Political Constitution of Peru, *Charter 59* says: “*The **State** encourages wealth creation and guarantees freedom of work and freedom of enterprise, trade and industry. The exercise of these freedoms must not be injurious to morality, or to health, safety or the public. The State provides opportunities for the sectors that suffer any inequality in this regard, promotes small businesses in all its forms*”.

In the 1990s, several meetings were held to improve the Education in Peru. First, in a meeting held between professors and entrepreneurs, it was agreed to create an educational council to submit a high-level national and reputed hierarchy. “Similar to the Central Reserve Bank but useful for Education as an independent institution going beyond the duration of any Government, whose purpose had been to set the outlines for the national education, to monitor its evolution and count on an institution with consistency, continuity and permanence based on educational policies without the never-ending interruptions and setbacks every time the Minister is replaced”. (Trahtemberg, 1993:64)

Secondly, the Peruvian proposal in the field of training pointed out special attention to the role of the Ministry of Education as the governing body of the

National Education System. (Congress of Peru, 1998:1). The proposal legislation at that time bore in mind the problem of financing and securities, considered mechanisms to increase funds through COFIDE²⁸ and extension of the guarantee funds, which make it possible to reduce the risk of financing whose main sources are loans from international development agencies, Inter-banking loans (15%), Bonds (11%), Equity (35%). COFIDE carries out a series of activities aimed at developing, strengthening and consolidating the business sector especially small and micro enterprises through the provision of information, orientation and training services. The main programs and lines of financing are: multisector investments programs, working capital programs, rural sector support programs and foreign trade programs. (COFIDE, 1992:2)

Similarly, in terms of marketing, the draft legislation promotes more active participation of the *State* through *Mi Empresa*²⁹ (My Company). *Mi Empresa* promotes the competitiveness of SMEs and the entrepreneurial culture of people, thereby contributing to economic and social development, inclusion and sustainability in the country, through the formulation and implementation of policies, programs and tools in a concerted public and private space. Moreover, it is responsible for the regional and local government coordination and promotion, together with development agencies in each zone. (Ministry of Labor and Employment Promotion, 2008:1-2)

Finally, it is expected to analyze the formalization instruments that should facilitate administrative paperwork and process, zoning, taxation and promotion mechanism for the establishment and operation of SMEs as well as the role the local government should play in these areas.

²⁸ It is a Financial Corporation of Development or Corporacion Financiera de Desarrollo in Spanish.

²⁹ It is a Promotion Institution of Mypes or Promocion de la Micro y Pequena Empresa in Spanish. Provide support to Mypes in entrepreneurship. In the 1990s, its name was Prompyme.

This paper shows that there are serious problems in the relationship between Mypes and Public institutions. For instance, due to the poor performance of the Judiciary in Peru, Mypes does not have efficient mechanisms, faster and available for the resolution of judicial disputes. Hence, if the *State* expects Mypes to become formal, the creation of an adequate environment is relevant. On the one hand, SMEs expect sales increase, taxes payment according to their possibilities (Mariategui 2008), and look for new markets. On the other hand, the *State* expect Mypes to become formal to collect more taxes and make new projects or programs that reduce poverty and avoid the migration effect from rural areas to cities. Therefore, to make it happen, the *State* ought to prepare some steps to attract entrepreneurs into the formal market. There are currently some institutions that can fit perfectly only if the State intensifies their promotion.

In Peruvian economy, an important disadvantage is the adaptation of unqualified people to new technologies. For instance, they have know-how in farming but are not aware of the possibilities to improve their knowledge through new ICT, which can make their product more competitive in a globalized world. Consequently, the *State* should start promoting the benefit to become formal explaining how to do business, increase sales and become more competitive. Nevertheless, the majority of the population are not informed on how to learn about doing business. Hence, they are still missing opportunities due to the lack of proper information by the *State*.

At the moment, there are teachers (institutions) and students (Mypes) but there is no actor to make that important connection due to the poor performance of the *State* in promoting the existence of important institutions ready to make *new entrepreneurs*.

The *State* represented by the current Government decides to prepare programs to boost rural development and therefore fight poverty. (Ministry of Finance and

Economy, 2007: 1) There is nothing further to say besides the analysis of market environment for entrepreneurship.

3.2 Characteristics of Market Environment

The relationship between Mypes and the State is an important subject in order to analyze the current legal framework versus the administrative system. Hence, it is important to clarify what kind of economic doctrine applies to the country so that it can assess how the economy is working through economic actors, such as the state, businessmen or workers. The Government rules the country temporarily whereas the State works permanently. Understanding this difference makes a clear panorama and makes it possible to know the reasons that trigger traditional politicians to create and change the policies in favor of any economic actor that controls the power. The absence of such conditions generated scenarios beyond the reach of entrepreneurs, which led to inefficient results. Most Peruvians depend on services, exploitation and exportation of natural resources or agriculture. In the 1950s, the 1960s and especially the 1970s, the industrialization policies, based on *import substitution* ³⁰(Daniels et al,2004:673) had little perceptible effect, mainly due to the strong economic crises of the late 1980s and the application of a drastic opening of neoliberal politics in the 1990s. Since the early 1980s and 1990s, Peru has gone through immense change, setting aside political issues from military government until dictatorship. The evidence suggests that the migration effect brings people not only from Peruvian provinces but also foreigners such as: Italian, French, English, Japanese and Arabic people, who for instance started

³⁰ “An industrialization policy whereby new industrial development emphasizes products that would be imported”

business in the field of garments. Some foreigners started business in Lima in the area known as Gamarra Market that started in the 1960s. Throughout the years, Gamarra has created new jobs for any businessperson downsized by companies and for those who are newcomers seeking new markets. In past years, only the lower class in Peru went to Gamarra to purchase what they, since it could be impossible even think to enter the shops located in posh areas of the capital. On the contrary, rich or middle class citizens had the possibility to attend others shops considered unaffordable for the majority of the population. According to ESAN, Gamarra has become an Emporium focusing on garments and related goods and services. For instance, if some newcomers want to rent a small office there, the smallest shop can cost thousand dollars. Even rich or middle class people want to set up their business but it is not easy due to the increasing price because of the demand of interested businesspeople. On the one hand, this Emporium offers cheaper prices and good quality, which are reasons that attract any customer. On the other hand, the location of this market and its demand makes businessmen want to set up any shop targeting family, kids, any Peruvian or foreigners. Nevertheless, this did not stop SMEs from investing there. The issue comes from the administrative system based on time and cost during the process of starting business.

At present, Gamarra has gone from the informal to the formal market, which seeks to enhance the competition. This business success story is not the only one in the country. Peruvian society has a boom in doing business (important interest of Peruvians to export). Also, it has a legal framework that attracts domestic and foreign investment but entrepreneurs have not been supported by the authorities or institutions such as the Judiciary or Municipalities in problem solving because they find barriers such as discrimination among Mypes and big companies. For instance, small businesses might obtain credit from cooperatives or other financial

institutions instead of Banks. Moreover, the law indicates the protection of employees rather than promotion of some institutions to contribute in their role as providers of incentives and consulting services to owners in increasing new sales, getting new resources or getting new partners in order to enlarge the firm and create more jobs, efficient for those people protected by Law N°28015. Although the formal firms are increasing, the remaining informal market is more than sixty percent, so the state survives using an indirect tax known as IVA. Despite the fact that Income tax should be used as a main tax in the country, SUNAT has used the IVA as an alternative to take advantage of formal business to collect money in order to maintain its structure and prepare projects to enhance infrastructure such as roads, sanitation etc. Table.2 shows the percents between small and micro business and large and medium business:

Table. 4 Positive Effects of Business in Employment and GDP

	Percentage of Businesses (*)	Employment	GDP
Large and Medium Business	1.65%	12%	55%
Small and Micro-Business	98.35%	88%	45%

Source: Pro- inversion and INEI 2004:93

“Ninety eight percent of Peru’s economic units are micro and small businesses (micro = ninety four point four percent, small = three point nine percent), which makes them a dynamic agent for the local, regional and national economy and an axis for economic development and generating jobs. The largest percentage (seventy six point eight percent) of these businesses is in the services and commerce sectors, while sixteen percent are in the industrial sector.

Besides, nearly three thousands five hundred of the country’s MYPEs participate in foreign trade. Two out of three exporters are micro and small entrepreneurs,

raising their exports from US \$ a hundred thirty three percent million in 2001 to US \$ two hundred seventy one million in 2004; while other MYPEs do not export directly but do so indirectly by supplying other exporters". (Pro- Inversion, 2007:93.)

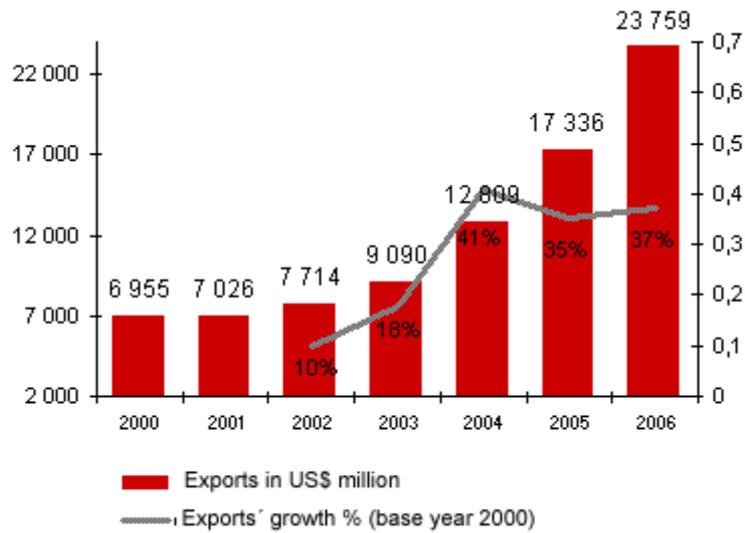
According to Visser's ideas³¹, "Cost reductions and information spillovers are the dominant type of advantages; these are however, passive advantages of clustering. They largely arise at the level of transactions in goods and services, and to a lesser extent in the transformation of inputs into output. While significant, these advantages are insufficient for sustaining competitiveness in the liberalized markets. The garment cluster runs the risk of entropic death if information spillovers remain limited in origin and diversity and if interfirm cooperation does not cross local borders". "After fifteen years of strong application of economic measures, and compared to an expanding global economy, have begun to appear positive results supported by the international situation but also by order in the internal accounts: Peru has recorded an outstanding economic development these last years, which resulted in Eight point zero three percent GDP growth in 2006, above six point four percent growth in 2005. These results are expected again in the next years, mainly through expected public and private investments, increased domestic demand and greater exports driven by the strong world economy. If per capita product keeps growing at an annual six percent, the estimated US\$ three thousands six hundred per year for 2007 would rise to US\$ five thousands seven hundred in 2015. Together with more equitable income distribution, it leads to a significant improvement in Peruvians' well-being" (Private Investment Cooperation Agency, 2007:1).

³¹ This paragraph provide analysis of the case of Gamarra Market that he consider an under develop garment cluster.

The new trend of exporting Peru is spreading to innovative items such as ice-cream shops, luxury boats, machinery for the food industry, furniture, soft drinks, clothing and fashion, computers, software, perfumes and jewellery(Figure .3) according to the Ministry of Foreign Trade and Tourism. Moreover, the government has created the National Commission of Products Flag ³²with the aim of achieving an exportable supply and consolidate its presence in international markets.

Figure. 3 Exports Growth of Peru

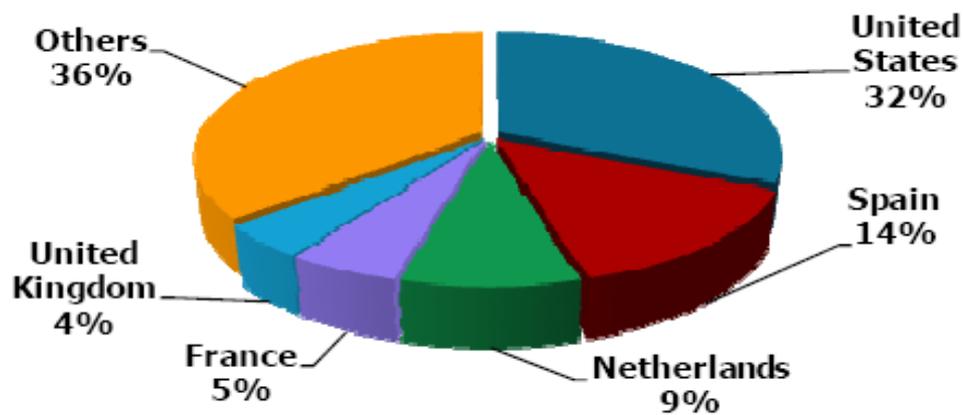
³² The COPROBA acronym in Spanish promotes the most important products of the country: Flag Products.



Source: International Monetary Fund and Central Bank of Peru / Estimate: INEI. Prepared by Pro- Inversion, 2007:2

In 2006, the government has given a package of measures to strengthen the economy, improve levels of investment and expand production and exports. Raw materials and agro-industrial products represent large potential export (Figure.4)

Figure.4 Agro- Industrial Exports Products by Markets 2007



Source: Pro-Inversion, 2007:21

Considering this case, the current policies are focusing on taking advantages of the mega diverse nature of the country. Therefore, its aim is getting financial resources and technological edge in order to boost industrial sector such as fishing, agriculture, mining, textile that represent the traditional and non-traditional sectors in terms of exports (Table.5).

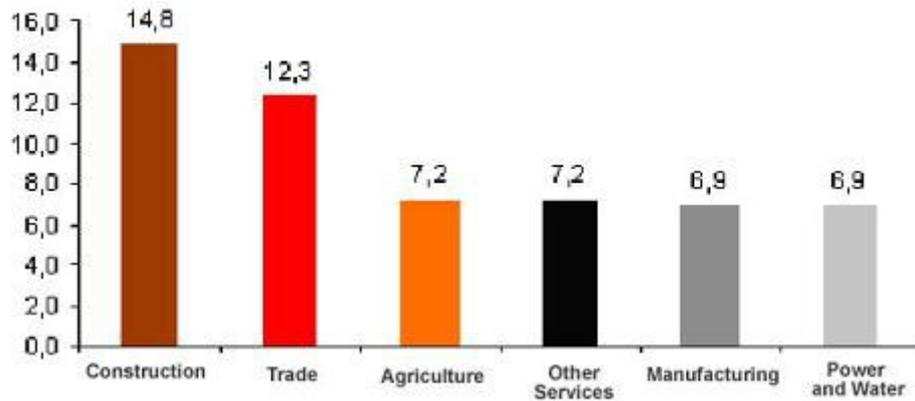
Table 5.Traditional and Non Traditional Exports

Exports	2005	2006	Var%
I. TRADITIONAL PRODUCTS	12 918,7	18 332,2	41,9
FISHERIES	1 303.0	1 331.4	2.2
AGRICULTURE	330.6	572.5	73.2
MINING	9 759.5	14 715.8	50.8
CRUDE AND BYPRODUCTS	1 525.6	1 712.5	12.3
II. NON TRADITIONAL PRODUCTS	4 276.5	5 262.1	23.0
AGROFARMING	1 008.7	1 212.0	
FISHERIES	322.5	432.1	34,0
TEXTILE	1 275.0	1 468.9	15,2
LUMBER AND PAPER, PRODUCTS	261.3	332.8	27,4
CHEMICAL	537.6	600.8	11,8
NON METALIC MINERALS	118.1	135.2	14,5
IRON AND STEEL AND JEWELRY	493.3	828.8	68,0
METAL-MECHANICS	190.1	162.5	-14,5
OTHER	69.9	89.0	27,3
III. OTHER	141,1	155,3	10,1

Source: Central Reserve Bank of Peru and Pro- Inversion, 2007:10

The strategy aims at boosting physical infrastructure through this financial and technologic support in order to enhance the following sectors:

Figure. 5 GDP per Sector 2006 (% var)



Source: Central Bank of Peru, 2007:8

3.3 Factors that encourage Entrepreneurship

According to the Grupo de Opinión³³ the strengths to develop entrepreneurial activities are natural resources, economic and political stability, innovation and Peruvian creativity. Furthermore, this survey reflected the good image of the Ministry of Finance and Economy as well as the Ministry of Foreign Trade and Tourism (November, 2007:4-9). Reforms of the domestic market can allow entrepreneurs to get ease development of their businesses, first inside the country to gain a portion of the domestic market, thus create competitiveness leading them to offer their products or services around the world.

According to GEM, “Entrepreneurs want to take advantage of a perceived business opportunity (opportunity entrepreneurs). They are pushed into entrepreneurship because all other options for work are either absent or unsatisfactory (necessity entrepreneurs)”. (GEM 2006:15). Moreover, Entrepreneurs want to gain personal achievement, being tolerant against risk,

³³ Group Public Opinion (GOP), multidisciplinary team of investigators made up of communicators, sociologists, philosophers, mathematicians and engineers of systems that are supported by academic and technological development of the University of Lima and help with the analysis of the national reality.

having control of situations and being efficient. (Stoner et al, 1996:179) Nevertheless, the lack of training or information makes Peruvians businesspeople fail.

Enhancing the standard of living, creating new business that represent not only jobs for Peruvians but also for foreign people. That way, the exchange of knowledge becomes useful for the development of those companies.

Ellen Fagenson asserts a different definition between entrepreneurs and managers: “Entrepreneurs in their reviews tend to have respect for themselves, freedom, or a sense of life exciting. Moreover managers typically provide real value to friendship, wisdom, salvation and pleasure. Fagenson concludes that entrepreneurs do not want to get the same things in life as managers. Clearly, the entrepreneurs need to have confidence in themselves, optimism and courage for starting and operating a business without assurance of a fixed salary. Sometimes, entrepreneurs decide to start new businesses because they cannot ignore their dream, their vision, and are willing to risk their safety in return for economic gain. In other cases, they are forced by circumstances beyond their control, such as staff reduction. They can feel frustrated due to the lack of possibility to move forward, or are driven by the need to coordinate their personal or professional goals. Given these circumstances, many people find the courage and confidence to assume control of their professional destiny”. (Stoner et al.1996, 179:180)

Peru is in a phase of economic growth and it is expected to sign agreements and treaties in areas of free trade so that it can achieve faster development and industrialization as developed countries. Every day, more and more Peruvians are involved in doing business especially in commerce and services. Traditionally, Peru ranks as the first producer of fishmeal, asparagus, woolen and paprika and the second producer of silver and artichokes. Last but not least, Peru is fourth in production of lead, copper and zinc and fifth in gold (Pro- inversion, 2007:7).

According to The International Monetary Fund Peru, in terms of economic growth, Peruvian economy is in fifth and sixth position - by the World Bank . (The Economist 2005)

To sum up, doing business in Peru is still very beneficial for entrepreneurs but with government policies, well prepared Mypes appear in the market seeking inclusion and competitiveness to enable them to compete nationally and internationally.

3.4 Barriers that discourage Entrepreneurship

In the past, the Peruvian regime not only adopted bad policies such as agrarian reform, expropriation, without any preparation of farmers in order to manage their own field, but also large- state owned companies have had a weak administration. This situation triggered increasing poverty and terrorism. Later in the 1990s, the new Government decided to introduce a shock strategy based on neo-liberal economy as a first measure. As a matter of fact, that regime reduced national consumption and fight against tax evasion in order to reinsert Peru into the international financial system thus showing the world that Peru is back. After that, the transition government of President Paniagua sought the improvement of the image of institutions such as the public system and the military forces but after his regime, the next two presidents oriented their strategies to exports in order to increase the numbers and prove that Peru is doing well in that sector. Part of this success comes from Mypes, considered as group, but the government does not consider them as individuals. Several mistakes in strategic planning have resulted in the lack of confidence of Peruvians towards their public institutions. Entrepreneurs use commerce as a tool due to the lack of jobs they find in the market. The lack of jobs and opportunities force people to start business in the informal way. People also find many disadvantages before setting up a business

such as financial support programs, governmental support, education and training programs, technology transfer, research for enterprise development, commercial and professional infrastructure, opening the domestic market, entrepreneurship infrastructure, and socio-cultural context. (GEM, 2006: 89-104).

There are ten procedures that disappoint people and sometimes others decide to quit before starting the formal or legal procedures.

Although, there are some private and public institutions placed throughout the national boundaries to enhance doing business, they do not count on strong national promotion campaign from the Government. Also, Government policies focus on improvement of national infrastructure to promote sectors such as construction or industry instead of focusing on controlling these public institutions to execute the law to benefit entrepreneurs. It is true that Mypes need training to compete in the market but due to the barriers found in the administrative system dissuades them from having a business friendly relationship with each other. According to IADB report, the State is said not to have complied with the agreements, disregarding the payment deadline. Thus, distrust makes them keep aside the system and this situation causes entrepreneurs to include in their costs the inefficiency of the Judiciary or Municipalities as part of decision making (2003:37).

The following tables show advantages and disadvantages in doing business. Thus, the comparison with the world's best economies seek to identify the Peruvian situation in order to improve those procedures; to see which procedures are doing well and correct and which procedures are doing, all in order to enhance business-friendly environment with clear Government incentives.

The procedure comparison with other OECD countries is as follows:

Table. 6 Ease of Doing Business

Ease of	DB 2008 rank	DB 2007 rank	Change in rank
---------	--------------	--------------	----------------

Doing Business	58	56	-2
Starting Business	102	96	-6
Dealing with Licenses	109	107	-2
Employing workers	159	160	+1
Registering Property	35	32	-3
Obtaining credit	36	32	-4
Protecting Investors	15	15	0
Paying Taxes	77	73	-4
Trading across borders	71	58	-13
Enforcing Contracts	119	121	+2
Closing Business	94	96	+2

Source: Doing Business Report 2007-2008:6

Starting a Business:

“The challenges of launching a business are shown below, such as the number of steps entrepreneurs can expect to go through to launch, the time it takes on average and the cost and minimum capital required as a percentage of gross national income (GNI) per capita.” (Doing Business Peru, 2007:6).

Table.7 Starting a Business

Indicator	Peru	Region	OECD
Procedures (number)	10	11.0	6.0
Duration (days)	72	60.7	14.9
Cost (% GNI per	29.9	36.9	5.1

capita)			
Paid in Min.	0.0	9.2	32.5
Capital (% of GNI per capita)			

Source: Doing Business Report 2007-2008:10

Dealing with licenses:

“Below are the procedures, time, and costs to build a warehouse, including obtaining necessary licenses and permits, completing required notifications and inspections, and obtaining utility connections”. (Doing Business Peru, 2007:6)

Table. 8 Dealing with Licenses

Indicator	Peru	Region	OECD
Procedures (number)	21	16.9	14.0
Duration (days)	210	238.6	153.3
Cost (% of income per capita)	165.0	268.2	62.2

Source: Doing Business Report 2007-2008:10

Employing workers:

“The difficulties that employers face in hiring and firing workers are shown below. Each index assigns values between zero and one hundred, with higher values representing more rigid regulations. The Rigidity of Employment Index is an average of the three indices”. (Doing Business Peru, 2007:6)

Table.9 Employing Workers

Indicator	Peru	Region	OECD
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Difficulty of Hiring Index	44	36.9	25.2
Rigidity of Hours Index	60	35.5	39.2
Difficulty of Firing Index	60	24.5	27.9
Rigidity of Employment Index	55	32.3	30.8
Nonwage labor cost (% of salary)	10	12.7	20.7
Firing costs (weeks of wages)	52	56.1	25.7

Source: Doing Business Report 2007-2008:10

Registering Property:

“The ease with which businesses can secure rights to property is shown below, including the number of steps, time, and cost involved in registering property”.

(Doing Business Peru, 2007:6)

Table.10 Registering Property

Indicator	Peru	Region	OECD
Procedures (number)	5	8.2	4.9
Duration (days)	33	58.9	28.0
Cost (% of property value)	3.3	5.0	4.6

Source: Doing Business Report 2007-2008:10

Obtaining credit:

“Measures on credit information sharing and the legal rights of borrowers and lenders are shown below. The Legal Rights Index ranges from 0-10, with higher scores indicating that those laws are better designed to expand access to credit. The Credit Information Index measures the scope, access and quality of credit information available through public registries or private bureaus. It ranges from zero to six, with higher values indicating that more credit information is available from a public registry or private bureau”. (Doing Business Peru, 2007:6)

Table. 11 Obtaining Credit

Indicator	Peru	Region	OECD
Legal Rights Index	4	4.1	6.4
Credit Information Index	6	3.4	4.8
Public registry coverage (% adults)	20.7	8.1	8.6
Private bureau coverage (% adults)	33.0	32.1	59.3

Source: Doing Business Report 2007-2008:10

Protecting Investors:

“The indicators below describe three dimensions of investor protection: transparency of transactions (Extent of Disclosure Index), liability for self-dealing (Extent of Director Liability Index), shareholders’ ability to sue officers and directors for misconduct (Ease of Shareholder Suits Index) and Strength of Investor Protection Index. The indexes vary between 0 and 10, with higher values indicating greater disclosure, greater liability of directors, greater powers of shareholders to challenge the transaction, and better investor protection”. (Doing Business Peru, 2007:6).

Table.12 Protecting Investors

Indicator	Peru	Region	OECD
Disclosure Index	8	4.2	6.4
Director Liability Index	5	5.0	5.1
Shareholder Suits Index	7	6.0	6.5
Investor Protection Index	6.7	5.1	6.0

Source: Doing Business Report 2007-2008:10

Paying Taxes:

“The data below shows the tax that a medium-size company must pay or withhold in a given year, as well as measures of the administrative burden in paying taxes. These measures include the number of payments an entrepreneur must make; the

number of hours spent preparing, filing, and paying; and the percentage of their profits they must pay in taxes”. (Doing Business Peru, 2007:6)

Table. 13 Paying Taxes

Indicator	Peru	Region	OECD
Payments (number)	9	48.7	15.1
Time (hours)	424	366.9	183.3
Profit tax (%)	27.4	22.8	20.0
Labor tax and contributions (%)	11.8	19.9	22.8
Other taxes (%)	2.3	13.9	3.4
Total tax rate profit	41.5	56.6	46.2

Source: Doing Business Report 2007-2008:10

Trading across borders:

“The costs and procedures involved in importing and exporting a standardized shipment of goods are detailed under this topic. Every official procedure involved is recorded - starting from the final contractual agreement between the two parties, and ending with the delivery of the goods”. (Doing Business Peru, 2007:6)

Table. 14 Trading across Borders

Indicator	Peru	Region	OECD
Documents for export (number)	7	6.7	4.5
Time for export (days)	24	22.6	9.8
Cost to export (US\$ per container)	590	1,095.6	905.0
Documents for import (number)	8	7.7	5.0
Time for import	31	24	10.4

(days)			
Cost to import (US\$ per container)	670	1,208.3	986.1

Source: Doing Business Report 2007-2008:11

Enforcing contracts:

“The ease or difficulty of enforcing commercial contracts is measured below. This is determined by following the evolution of a payment dispute and tracking the time, cost, and number of procedures involved from the moment a plaintiff files the lawsuit until actual payment”. (Doing Business Peru, 2007:6)

Table.15 Enforcing Contracts

Indicator	Peru	Region	OECD
Procedures (number)	41	37.7	31.3
Duration (days)	468	754	443.3
Cost (% of claim)	35.7	30.3	17.7

Source: Doing Business Report 2007-2008:11

Closing a business:

“The time and cost required to resolve bankruptcy is shown below. The data identifies weaknesses in existing bankruptcy law and the main procedural and administrative bottlenecks in the bankruptcy process. The recovery rate, expressed in terms of how many cents on the dollar claimants recover from the insolvent firm, is also shown”. (Doing Business Peru, 2007:6)

Table.16 Closing a Business

Indicator	Peru	Region	OECD
Time (years)	3.1	3.2	1.3
Cost (% of estate)	7	16.4	7.5
Recovery rate	24.7	25.9	74.1

(cents on the dollar)			
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Source: Doing Business Report 2007-2008:11

Through data collection, it is possible to observe that most disadvantage items are starting business, dealing with licenses, employing workers, registering property, obtaining credit, paying taxes and trading across borders, followed by enforcing contracts and closing business. Furthermore, entrepreneurs find many burdening administrative procedures when trying to obtain credit and register property. Besides this, they do not find safety in protection of their investment. Therefore, the Government should start the reforms focusing on the red numbers in Table 4. The legal framework set the rules but not the punishment of the execution procedure, which shows it is weak. Thus, taking out the negative numbers minus twenty nine from Table 4 for our analysis of the problem of doing business, it starts from the beginning. For instance the delay, paper works and payments only to set up a business or dealing with licenses is a slow process led by the Municipalities. The reality shows not only informal but also some formal SMEs that do not carry out the law because they cannot afford the broad requirements and high percentage of welfare for their employees. There are many effects of informality growth in doing business through commercial activities. One of them is due to the lack of precarious nature of the property deeds: in some cases, the lack of legal deeds delays access when obtaining credit. One disadvantage of SMEs is seeking financial support. It is often alleged that they prefer to resort to other financial institutions such as cooperatives in order to get a credit since Banks do not allow a loan without guarantee. As a consequence, they are

restricting the modalities for the maximum credit, working almost exclusively with sales in cash: the best way to ensure payment of debts is to sell in cash or request partial payment, a frequent and widespread practice among Mypes. In addition to this situation, SMEs do not invest in the company's growth. Moreover, they avoid hiring new employees, associate with other companies, and also avoid production diversification and so on. In fact, the high cost of registering property and paperwork in Peru makes Mypes avoid its application due to unfair payments that not depend on the level of SMEs income. Mypes make decisions that have serious collateral effects such as: reduction of number of transactions and higher cost. On the whole, Mypes conducts business with customers and suppliers that they already known despite cost increases, employers do not often change their suppliers even if it means making inputs at a lower cost. Moreover, they avoid making joint purchases which could reduce input costs and / or improve quality and finally avoid joint sales. This situation occurs because entrepreneurs that prefer to pay higher costs but are assured that the counterpart will respect the agreements. Further, they avoid outsourcing for the same reasons mentioned above. It is commonly believed that confidence is the key element in the *modus operandi* among SMEs.

Other disadvantage of being formal is based on high tax system which collects most taxes from purchases. SUNAT has reported that Mypes contribution is relevant for national purposes. Nevertheless, the State does not make reforms that enhance the sustainability of Mypes in the long run. From the viewpoint of SMEs, it is vital to enhance these benefits based on time-cost otherwise the issue of informal entrepreneurs will continue. If they are formal, businesspeople would not like to pay high taxes and receive less benefit.

The Top Reformer in 2007-2008 is the Arab Republic of Egypt, improving in five of ten procedures in Doing Business (2008:7). For instance, starting a

business is easier and the minimum capital requirement has reduced from fifty thousands to one thousand Egyptians pounds and half the time and cost of startup cost, the creation of new one stop shops to finish the procedures within forty eight hours by the general authority for investment called GAFI³⁴.

In Peru, factories and companies have fewer infrastructures especially inside the country. Therefore, poor people from the rural area, especially from Andean regions migrate to the capital or other coast cities looking for better opportunities. First, they get a job and settle down. Secondly, they make money to bring their family or send remittances back home, trying to improve their lives in order to meet some basic needs.

As a consequence, the current Government decides to set up a program called Sierra Exportadora³⁵ in order to create solutions for unemployment and poverty reduction and create local self-employment in those rural areas, thus, preventing migration to other urban cities, which already have their own unemployment issues.

Currently, Sierra Exportadora contributes with twenty two percent of GDP (annual growth average from 1970 to 1996 was one point nine percent and Sierra was less than one percent of that average). According to National Survey of 2000, more than eighty percent of population used to work in sectors such as agriculture and mining. (Sierra Exportadora, 2007: 14). Therefore, this region has natural resources and centuries of tradition based on agriculture and cattle. Nevertheless, the production capacity has not been efficient. For instance, the hydroelectric plant provides sixty five percent of the electricity, which comes from this part of the country and Sierra only uses four percent. Also seventy two percent of

³⁴ GAFI is the General Authority for Investment and free zones.

³⁵ Mountains Exporter is a program designed by the current government in order to develop rural economical activities in the mountains or Sierra in Spanish. The Congress approved this program, under Law N° 28890.

agriculture production consumed on the coast is provided by Andean regions. Apart from this, mining sector exploited by FDI is an essential activity that contributes with more than fifty five percent of exports. Finally, the textile sector also contributes with almost eighty percent from Andean animal fur such as sheep. Clearly, there are cultural, social, climate and traditional reasons to promote entrepreneurship in this vast area of the country. It is known that mining is a very attractive sector for Foreign Direct Investment (FDI), which would represent more benefits for Andean regions rather than foreign firms. On the one hand, Large Enterprises bring technology, know-how, physical infrastructure and job creation for Peruvians. On the other hand, the revenues for these companies do not reinvest in the region especially in those rural areas with basic needs. It is a known fact that FDI is an important way to receive inflows from developed firms. On the one hand, the State creates a legal framework that gives incentives to FDI because of technological transfer and job creation. On the other hand, Mypes do not receive the same treatment through incentives such as tax exemptions. However, these foreign enterprises do not comply with the previous agreement between the Government and them, due to the weak performance of public institutions to execute the punishment when the LEs break the law, for instance global warming issues. In the Law of foreign investment, concrete guarantees are granted to the investors on the convertibility and repatriation, particularly the right to send utilities abroad freely, benefits of assets sales, privileges and payments for technology use and the access to the most favorable exchange rate in the entry and exit of currencies.

As a general rule, these big companies coming to Peru make acquisitions, export and receive important revenue that in their majority is reinvested in other

economies due to the lack of reinvestment incentives given by the national Government. In other words, the Government has not made greater efforts to protect the market environment of doing business, focus on the sustainability of SMEs. The legal framework offers benefits to FDI and Public Investment, but it does not create business-friendly environment for Mypes.

In fact, there is a high level of payments of taxes due to the existence of new firms in the local market. Yet that situation does not enhance the conditions of the owners since they have to pay a percent of taxes before they gain the money for each sale, known as Detraction tax³⁶ (Detraction Tax, SUNAT Library).

Indeed, the lack of new Government policies does not enhance the market environment in favor of Mypes. Furthermore, they want to increase their sales providing more services or outsourcing to big companies but the lack of information and technological training hampers this connection. Also, being informal does not allow them to get suitable information whereas as a formal, they would not receive incentives that allow SMEs to grow in doing business with big companies. Therefore, Entrepreneurs (ex- employee or current employees from LE) think it twice before running their own business. In practice, they realize that there is not a business friendly environment to protect them so they could compete or provide outsourcing to LEs against local or foreign firms. Maybe they know the legal framework in the market is secure but not secure enough to allow their firms' growth as fast as it should. The specialist-made new policies would strengthen them when doing business without barriers, where taxes such as income or IVA (VAT³⁷) are needed to create or improve infrastructure seen in roads and sanitations that improve geographical conditions to set up business into

³⁶ Detraction tax System of IVA in Spanish called Sistema de Detraccion del IGV. It is mechanism created by the State in order to guarantee the payment of VAT in sectors with high level of informality.

³⁷ Value Add Tax known as Impuesto al Valor Agregado (IVA) in Spanish.

national territory. The outcome of all this would reflect the prosperity of these businesses and would offer a vision of investment in the long run.

New trend is to run your own business in order to secure your retirement with better savings rather than lower compensations from conventional jobs. Other important element in this discussion is Family protection. For that reason, entrepreneurs want to set up their own business in order to provide the best education to their children. In other words, good education means huge investment from primary school to tertiary level. Reality shows that people come from provinces for Education and Healthcare because the lack of physical infrastructure or qualified professionals forces them to migrate to the cities. It is a fact that Health and Education have not been improved equally for all Peruvians and it has caused the migration effect that makes most Andean people leave their households to look for job opportunities or education. Yet, it is reported that the employment market in the cities are not good enough due to low salaries and the huge demand of professionals in some fields such as: accounting, management, etc. Taking the above problems into account, challenges are still remaining in terms of an appropriate environment to fight against limitations and taking the potential benefits.

It is time to change because Peru has always been the supplier of primary products. It represents half their share of total exports for the 1985-2000 period. On the one hand, foreign investors have always been given exemptions because they have technological and financial resources. On the other hand, Mypes is synonymous of high taxes and lower incentives. There is much more informality and less sustainability of Mypes.

To sum up, the Government policies need to eliminate high cost of formalization process such as: bureaucratic barriers, infrastructure, labor and high taxes. There is a necessity to eradicate of legal instability, lack of incentives for innovation,

centralism and the lack of planning in order to have a productive economy and a long-term vision.

Chapter 4

Implications for investment policies to promote entrepreneurship

4.1 Current Market Policies in Peru

Peru is recognized as an attractive legal framework for national and foreign investment with the purpose of attracting financial and technological resources necessary to develop the great natural resources and opportunities in the nation. As a matter of fact, investment plays an important role in the country's economic growth. In the past four years, Peru has shown some signs of a promising future, needless to say that if investment create more jobs for Peruvians, this situation will be have positive effect on training future entrepreneurs (Table 17). For instance, from 2007 to 2010 the steady situation will allow economic growth in seven percent average. Besides, the current government has decided to make reforms in social programs and tax framework. Apart from this, there are some signs of good will of the new Administration so as to allow the creation of welfare for everyone especially for those facing poor conditions or undernourished infants.

Table.17 Investment Effect on the Country's Economic Growth

	2004	2005	2006	2007
GDP(% change)	5.1	6.4	7.6	8.9
Private Investment(% change)	9.1	13.9	20.1	24.0
Public Investment(% change)	5.7	12.2	13.0	27.0
Jobs in firms with 10 or more workers(% change)	2.7	4.5	7.3	8.7
Exports(% change)	40.9	35.3	36.9	16.3
Capital Goods Imports(% change)	19.6	29.6	35.4	41.0
Construction GDP(% change)	4.7	8.4	14.7	16.5

Tax Collection(% change)	13.6	14.3	27.8	15.0
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Source: Central Reserve Bank of Peru, INEI and SUNAT, 2007:3

Clearly the positive results during last years have facilitated the creation of new investment opportunities such as roads, infrastructure, airports, ports, sanitation, hydrocarbons, energy, telecommunications and electric train (Table. 18) (Pro-Inversion, 2007:34). The strategic plan of the central Government is to reduce the poverty at least ten points and infant malnourishment in five points during its five years of Administration (MEF, 2007:1). Therefore, the current Administration is reported to seek an inclusive market, so it is the best moment to enhance a business-friendly environment for Mypes as well.

Table.18 Investment Opportunities

SECTOR	ESTIMATED INVESTMENT (US\$ MM)
Energy	994
Land Transport	631
Sanitation	329
Ports	411
Agriculture	332
Airports	157
Hydrocarbons	143
Telecommunications	180
Others	116*
Total	4042

* Decentralized 62 US\$ million: mining US\$ 30 million and tourism US\$13.5 million.

Source: Pro- Inversion, 2007:38

The 1993 Constitution includes provisions on essential principles to guarantee a favorable juridical framework for the development of private sector investment

and particularly foreign investment. “Some of them are: Free private initiative exercised in a market-based social economy; freedom of work and engagement in business, trade and industry; definition of the subsidiary role for the State in economic activity; free competition and prohibition of restrictive practices and the abuse of dominant or monopolistic positions; freedom to engage workers; powers of the State to establish guarantees and grant securities by means of contract law; national treatment; right to submit controversies arising from contractual relationship with the State to national or international arbitration; freedom to hold and dispose of foreign currency; inviolability of property and establishment of conditions for exceptional causes that empower expropriation, specifically, in-advance cash payment of a fair-value; equal treatment on taxation matters and the express acknowledgement that no tax may have confiscating effects”.(Peruvian Constitution, 1993)

The Foreign Investment Promotion Law, approved by Legislative Decree 662, 1991 and Legislative Decree 757 approved in 1993³⁸ is based on the equal treatment for national and foreign capital. Hence, foreign investment is allowed to be accepted in any economic sector. The general legal framework for the treatment of foreign investments is complemented by the Framework Law for Private Investment Growth, approved by Legislative Decree 662 and Legislative Decree 757 and the Regulations of the Private Investment Guarantee Systems, approved by Supreme Decree N° 162-92-EF; as well as modifying regulations. No prior permission is required due to its foreign status. Once made, the foreign investment shall be registered with National Commission of Foreign Technologies – (CONITE³⁹). The investor shall fulfill one of the following investment commitments: Foreign Direct Investment, as contribution to the capital stock;

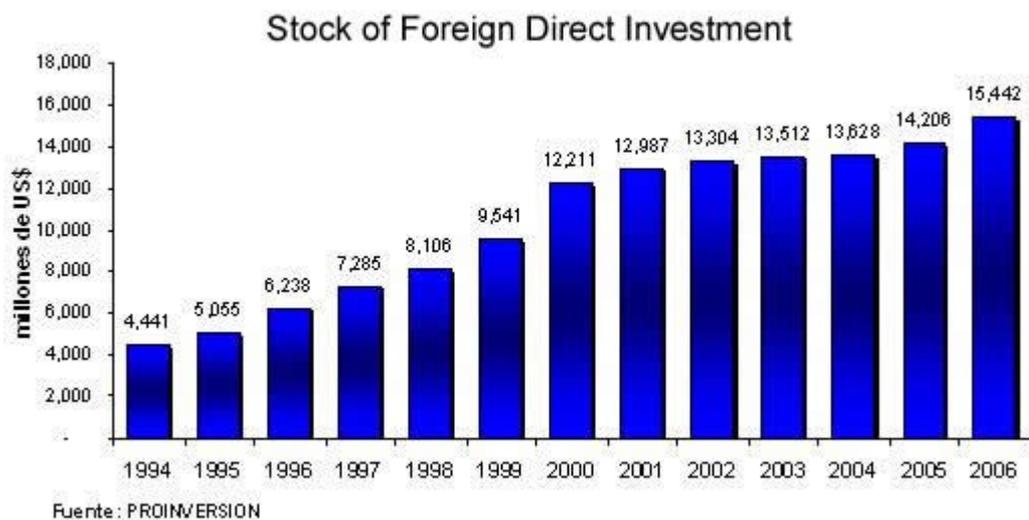
³⁸ Both Legislative Decrees 662 and 757 is the cornerstone of a sound legal framework that establishes clear rules and security for the development of foreign investments in the country.

³⁹ Known in Spanish as Comision Nacional de Inversiones y Tecnologias Extranjeras

contributions for the development of contractual joint ventures; investment in goods and properties located within the national land; portfolio investments.

At the time of the Investment Policies Review, Peru had been exceptionally successful in attracting foreign direct investment (FDI) (Figure. 6), although this was to some extent linked to its privatization program. Peru has faced the challenge, based on its success to attract investments in new areas. The IPR recommended the following measures: Fine-tuning the investment framework; strengthening investment promotion; strengthening Peru's competitiveness and FDI; encouraging regional cooperation.

Figure .6 Evolution of Foreign Direct Investment - Peru



Source Pro-Inversion on 30 June 2007:105

It is a known fact that FDI is important to Peruvian economy (Table.19), but one suggestion would be to enhance the impulse of Mypes with more participation of these big companies in doing business, supported by an equal administrative system that can execute decisions applying the rule of Law without bias.

Table.19 FDI Stock by Main Countries

COUNTRY	2007
SPAIN	4 622,3
USA	2 676,6
UNITED KINGDOM	2 552,9
PANAMA	870,4
NETHERLANDS	821,2
CHILE	520,8
MEXICO	437,2
COLOMBIA	351,3
BRAZIL	336,0
SWITZERLAND	272,2
JAPAN	242,8
CANADA	241,2
URUGUAY	175,3
AUSTRALIA	155,8
ITALY	144,6
SINGAPORE	123,5
CHINA	122,2

Source: Private Investment Promotion Agency, 2007:105

If the government has decided to enhance the market toward FDI, pointing out rights granted by the Law to foreign investors such as: “Non-discriminating treatment against the domestic investor, free remittance of profits or dividends, free re-exportation of their capital, unrestricted access to domestic credit, free acquisition of technology and remittance of royalties, freedom to acquire shares owned by national investors, freedom to contract abroad insurances for their investment, there is a possibility to conclude with Law Stability Agreements with

the State for their investment in the country”. Therefore, the results have to be useful for Mypes as well, meaning that LEs are linked with these Mypes but the current conditions do not guarantee the feasible development for SMEs in the market environment. Apart from that, Peru imports technology from developed countries. In other words, Peru imports facilities from abroad without doing anything else to improve competitiveness. On the one hand, there are early stages of government’s policies, reinforcing the field of skills development, enhancing the science and technology base on intensification of investment promotion functions. Peru has achieved the best practice in key aspects of the protection of investments and specific standards for treatment. On the other hand, Mypes have not gained all the benefits as an individual, thus slowing down the development of each firm.

In this regard, the Peruvian regime of investment policy is favorable in comparison to the other APEC economies, including those with strong natural resource sectors. (UNCTAD, 2000:10) Clearly, FDI rely on resources, workers, suppliers, and customers. Hence, it is necessary to improve the competitive capacity of the resource-based industry to promote investment in upstream industries as well as Mypes’ training by public and private institutions as a role of national competitiveness improvement.

Taxation has been partly simplified (Mariategui 2008) in order to apply general measurements with competitive valuations on broad basis. As a matter of fact, the main taxes of societies are the revenue tax, the added value tax and the imports rights. Also fiscal incentives are offered on regional basis and for sectors.

The effect of FDI in Tax system allows State to make improvements in Education, Healthcare, and infrastructure in those rural areas to improve life quality for everyone especially the poor. Therefore, new entrepreneurs from provinces may

prefer to remain there and develop their community because they would have better roads, schools, hospitals, etc.

4.2 Limitations of policies to address the present environment

There is a decentralization process and the Ministries are loosening a number of economic liabilities to Regional Presidents to implement those areas in need in order obtain benefits for their own regions. Unfortunately, they have been given the financial resources but not proper training.

There are reported cases in which the Regional Presidents were given the resources for their jurisdictions but the lack of their capabilities showed opposite results. For instance, in 2005 the mining royalties from foreign firms were transferred (170 million) to certain regions so as to improve health and education and fight extreme poverty. Indeed, the results have not shown improvement in education or healthcare, only certain signs of poverty reduction (Sierra Exportadora, 2007:20).

The Regional Presidents failed at executing a proper plan, neither did they create projects. Although the Government appreciates the long term process, it is necessary to have an effective business policy to boost the interests of entrepreneurship. No immediate plans are in place for the implementation of suitable business-friendly environment. The role of each Regional President is to prepare and execute the project to build up physical infrastructure such as roads, telecommunications in order to commute the rural area with the city. Actually, this function is not completed, especially in provinces far from the capital city. Thus, there is no guarantee of a good environment to set up new business. In other words, more corruption in delayed procedures and every modus operandi is a point of contact and an opportunity to get a bribe in the country.

There are many cumbersome regulations and studies show they help product quality neither do they make work safer or reduce pollution from Large Enterprises located in provinces, especially in mining. This issue, restraining private investment, pushes more people into the informal economy, increase consumer prices and encourages corruption. Due to the great discoveries of oil and gas reserves, it is expected that by 2010 Peru will become an oil exporter, after having been an importer over decades. Nevertheless, despite the economic dynamism of recent years, the recent economic crisis and neoliberal drastic measures have led to a strong lack of capitalization of the national economy with an insufficient presence of domestic companies while openly work in favor of the foreign capital that has tax exemptions and hardly any reinvest the profits inside the country. (MEF, 2008:1)

To sum up, Peru has an excellent situational diagnosis with information but the lack of the qualified people hinders the preparation and execution of projects. Politicians fail time and again to carry out this duty because they are unwilling to hire appropriate managers in order to apply the experience and knowledge in the development of each region. It is necessary to reverse the policies that can openly work in favor of Mypes in order to create strong and sustainable domestic companies.

4.3 Alternative ways to develop a friendly environment

In the past, FDI has been important in difficult moments for the Peruvian economy. Moreover, Peruvians' FDI has evolved and it is time to take advantage of LEs in favor of Mypes so as to boost economic growth and development.

Natural resources plus good economy have attracted FTA⁴⁰, which provide infrastructure, job creation and certain level of technical training in the country. Meanwhile, the traditional exports such as agriculture or fishing show signs of doing business without high-quality training and high-quality technology transfer. Additionally, exports in Peruvian economy have evolved from agriculture, mining, and fishing to textile, forestry, jewelry, handicraft and so on. As a result, these sectors (especially Mypes) have not taken advantages of producing more goods because they have not been prepared by new technologies that could increase their sales.

Currently, there is a strong promotion on the export sector. For that reason, more Mypes want to be part of this new opportunity. Yet, the lack of well prepared people reduces the possibilities to only a few entrepreneurs.

As an alternative, we need to give safe and strong incentives to micro and small enterprises since they have sustained and will sustain the economy of the country. For instance, five million Peruvians have proved success doing business and gaining small fortunes. Unfortunately, they were not given the support of a proper organized body of the State for business guidance. In contrast, whether any of them succeed in doing business, public institutions make more and more barriers or taxes that prevent the growth of these new firms in the long run. Therefore, a way to encourage these people is training them with existing agencies that are not fully used. For instance, The Ministry of Labor and Employment Promotion has presented workshops about how to start doing business. Prompex⁴¹ has workshops

⁴⁰ Free Trade Agreement

⁴¹ Prompex -Peruvian Export Promotion is an agency to promote export in Peru.

providing entrepreneurs with the accurate information about the export process. Intermesa⁴², the National Program for Municipal Simplifying Procedures (Chang 2006) and IPAE⁴³ have courses on Entrepreneurship. The Government needs to increase private enterprise contribution to economic development. Currently, the contribution relies on these micro and small firms. For that reason, the policy should change to avoid creation of more taxes to the same firms, taking into account that Georgia's case reduced jobs regulations to facilitate in getting better jobs. The contributions in social security went down from thirty one percent to twenty percent. As a result the employers feel free to hire new staff. (Doing Business Report, 2006: 4)

First, the issue is to reduce informal business and become formal in order to contribute to the economic development through taxes and so on. The law partially creates this situation but many people do not have the knowledge to understand the benefits to be formal. Secondly, there should be awareness of teaching values in the mindset addresses investment through suitable education and training in order to show people how to succeed in doing business. After that, there is the creation of the team-work idea in order to become more competitive. For instance Peru farmers or handicraft are used to selling in small portion as individuals but this approach does not work in a competitive world especially with the FTAs (Table.20) and any opportunity to export (Figure 7).

Table.20 Bilateral Investment Agreements

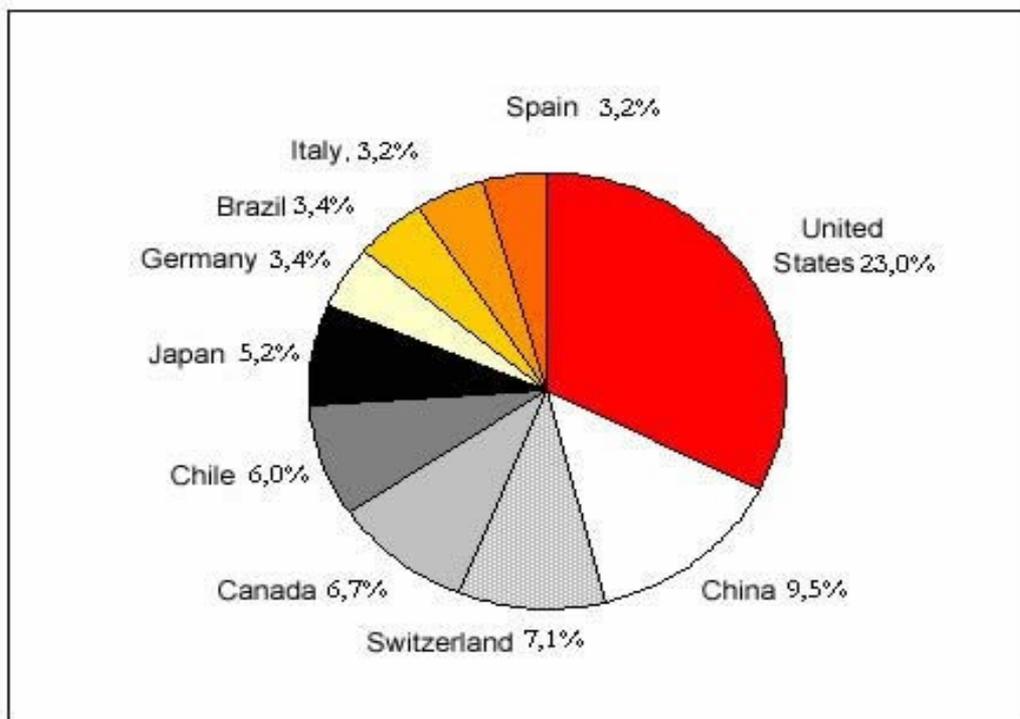
⁴² Intermesa is a program that seeks to facilitate municipal license presented at Convention for the Internationalization of Mypes.

⁴³ Peruvian Institute of Business Administration

COUNTRY	STATUS	COUNTRY	STATUS
GERMANY	IN FORCE	MALAYSIA	IN FORCE
ARGENTINA	IN FORCE	NORWAY	IN FORCE
AUSTRALIA	IN FORCE	NETHERLANDS	IN FORCE
BOLIVIA	IN FORCE	PARAGUAY	IN FORCE
CANADA	IN FORCE	PORTUGAL	IN FORCE
CHILE	IN FORCE	UNITED KINGDOM	IN FORCE
COLOMBIA	IN FORCE	THE CZECH REPUBLIC	IN FORCE
CUBA	IN FORCE	THE REPUBLIC OF KOREA	IN FORCE
DENMARK	IN FORCE	PEOPLE'S REPUBLIC OF CHINA	IN FORCE
ECUADOR	IN FORCE	RUMANIA	IN FORCE
THE SALVADOR	IN FORCE	SINGAPUR	IN FORCE
SPAIN	IN FORCE	SWEDEN	IN FORCE
THE UNITED STATES	APPROVED	SWITZERLAND	IN FORCE
FINLAND	IN FORCE	THAILAND	IN FORCE
FRANCE	IN FORCE	BELGIUM-LUXEMBOURG ECONOMIC UNION	APPROVED
ITALY	IN FORCE	VENEZUELA	IN FORCE

Source: Pro- Inversion, 2007:16

Figure. 7 Trade by Countries



Source: SUNAT, 2006:12

It intends to do so by having an investment in business-friendly environment conducted to the maintenance of new investment creation. In attempting this, it is known that the Government's concern will be the protection of public health and

safety, achieving growth and revenue accumulation for public expenditures and also allows the private sector to reach its own profit objectives.

The world is currently based on Knowledge Based Economy, or the New Economy or the Innovation driven Economy so that government intervention is based on the four pillars such as: good economic and institutional regimes through policies, human resources through well-educated and skilled population, dynamic infrastructure through effective ICT and last but not least, national innovation system through R & D looking for private partners such as universities, innovation institution. (Hong, 2007, Lecture 8:17)

As a benchmark, Singapore is top rank in Doing Business 2007-2008. (DB, 2008: 6). This country has a complementary policy to attract Multinational Corporations with complementary assets such as: Infrastructure, human capital, fiscal incentives, etc. The State is not interested in competing for technological matters like Japan, US or Korea. Therefore, Singapore's competitiveness focuses on value added chain to enhance the sequence of activities and at the same time a firm purchases inputs up to finished product. Besides, this Asian country is placed in Innovation- Driven Stage⁴⁴, whereas Peru is still in Factor-Driven Economy⁴⁵. (Porter, 1990)

Egypt, as a developing country, is the top reformer in Doing Business 2007- 2008. It made 5 reforms that improved the way of doing business through one stop shop known to help investors to accelerate the procedure in setting up business. (DB, 2008:7)

All things considered, boost of infrastructure, human capital and incentives should come from the Government's policies to attract Mypes to participate in learning

⁴⁴ The ability to produce innovative products and services at the global technology frontier, using the most advanced methods is the dominant source of competitive advantage,

⁴⁵ Basic factor conditions such as cost labor and unprocessed natural resources, firms produce commodities or relatively simple products in other, more advanced-country.

process or technological transfer to apply to rural areas thus, create new jobs and avoid the migration effect that increases other issues in the cities. Furthermore, boost of public institutions in sectors that show symptoms of failure and weakness. Last but not least, the Government would take an example based on minus twenty nine in doing business report 2007-2008 to start the reform in some institutions. Obviously, Peru's ranking shows another fall in the doing-business rate. This negative rate makes a snapshot of the issue that entrepreneurs have to overcome day by day. The Government should start highlighting those weaknesses in order to prepare a feasible plan to change the current disadvantages in favor of entrepreneurs.

In the past, The Unified register changed the Tax Declaration System but it is necessary to reform some taxes as an incentive for SMEs. The Government now needs technical assistance for organized institutions that can make Mypes strong, with legal forms to organize businesses so they can be prepared to do business in an expanded market. An adequate strategic plan from other experiences will obviously provide lessons to the Peruvian economy to prepare its own plan and assist Mypes with legal tools to increase access to market and consequently pull themselves out of poverty. For the Future, an inclusive market allows everyone to contribute to the economic development of the nation but also to increase life standards through business friendly environment.

To sum up, economic freedom has positive effects on social welfare, promoting education, health and it also can improve the institutions that should be part of the solution rather than part of the problem for Mypes.

Chapter 5

5. Conclusions & Recommendations

SMEs properly directed, organized, administratively protected, can become a necessary and indispensable instrument for economic development. Moreover, they should learn how to make an accurate strategic plan and budget by Government support through policies focusing on gathering private and public institutions ready to perform as consultants in fixing external disadvantages such as administrative system whereas internal issues from Mypes, focus on planning information and create a visionary culture and a constant mentality to be aware in advance, in order to foresee development of business or making plans in the short, medium and long term.(Lima Public Accountant's Associations, 2005:9-19)

Since the 1990s reforms, by registering in the Unified Business Register, entrepreneurs have been given benefits by tax credits. The success of the Unified Business Register suggests that policy makers have to create incentives for micro-entrepreneurs by intensifying opportunities to make formality more appealing and convenient in cost reduction.

The simplifications of requirements do not seem to be sufficient to foster formalization. So, the importance of giving incentives to entrepreneurs is also stressed by the low fulfillment of the Municipal license. The low degree of fulfillment with the Municipal license has two main explanations: First, the license is often considered a very high cost, as it is a fixed cost and it is not related

to the profitability of the activity. Second, the license does not provide entrepreneurs with expanded market opportunities.

The law regarding Municipal licenses has to be changed so that these entrepreneurs can become formal (Chang 2006). A first option could be to eliminate the obligation of complying with the Municipal license. Nevertheless, it might not be feasible for Municipalities, as licenses are one of the sources of revenue for local authorities. A second more applicable option is to modify the law by creating incentives for entrepreneurs and thus making formality more desirable. This could be done by providing some advantages in terms of market opportunities and by making the cost of the license proportional to the income or profits of the micro-entrepreneurs. For instance, notice the simplification process of licensing operation undertaken by INTERMESA, Municipalities specified in drastically reducing the number of steps and time.

The formalization of entrepreneurs should not be considered a policy objective. “A higher degree of formalization is desirable only if it leads to greater welfare for Mypes. For this reason, policy makers should pursue formalization by creating incentives for formal entrepreneurs” (Zuin, 2004:24-5). A higher degree of formalization should be the consequence of greater advantages of being formal, indeed.

Although providing new entrepreneurs with incentives is necessary to achieve a higher degree of formalization, it may not be sufficient. To succeed in increasing formalization, policy makers should take into account the importance of adequate information. Targeted information to entrepreneurs about the benefits derived from complying with the law could be useful to achieve this goal. Additionally, business associations could accelerate the process of formalization by representing the interests of entrepreneurs and by improving knowledge of services (such as regarding fiscal counseling, etc.), which could help small

businesses comply with formal regulations. There are institutions ready to assist SMEs such as The Platform for Financial Services COFIDE; program to support to Mypes of National Bank allows credit to reach the most remote areas of the country, control the return of credit and the national development program of suppliers of the Ministry of Production.

Finally, although Mypes are often considered a potential for employment generation and development, there are still many obstacles that SMEs have to overcome to play a dynamic role in the economy. These obstacles have to be removed from the top, by targeting adequate macroeconomic and microeconomic policies with a friendlier legal framework for micro-entrepreneurs and workers themselves. In other words, the Government should improve public institutions and administrative capabilities to improve governance for Mypes to recover their real potential in developing inter-industry linkages LEs supplier. Consequently, they contribute in the creation of employment and growth. Thus, the objective should make investment policies and procedures that are effective and efficient, incorporating the principles of transparency, simplicity and automaticity. Therefore, the role of Government should be required to set up technological transfer. Also it must be forgotten that the role of State is to provide basic needs to population but this research has shown that the Government probably will not use part of GDP to improve Healthcare despite having received grants from donor countries as well as development banks such as World Bank to solve these issues. Furthermore, the lack of formal Mypes does not allow Sunat to collect more taxes. If the situation changes, if there are more formal businesses, there will be more percentage of those taxes to fight poverty and undernourishment.

The Government is now willing to combat these issues, but most health issues such as reduction of maternal mortality and child mortality or fight diseases have not reached their goal.

The Private Sector such as successful business, institutes, universities and specialized factories plays an important role for R&D⁴⁶ too. Moreover, FDI creates the possibility of development of new entrepreneurs who can watch and imitate especially production management and marketing. As a result, trade liberalization not only makes a range of inputs available at lower prices and lowers production cost but it also opens foreign markets for entrepreneurship. The financial sector should be reformed, which is needed to facilitate entrepreneurs to obtain credit so they can set up technology transfer as a requirement, including rural areas. In other words, it is necessary to improve the living conditions in rural area.

On the one hand, the Government should help Mypes, earn more income and have a better quality of life. It is necessary to avoid centralism and migration, through the creation of one stop shop around the national territory to facilitate investment and stands ready to assist license acquisition at no cost for the investor, as well as the implementation of new regulations and policies related to competitiveness among firms. On the other hand, Trade creates development opportunities, but other factors will determine the extent in which those opportunities will be taken advantage of. In other words, expanding the demand for domestic firms, so that goods enabling them to serve a larger market. Consequently, most Peruvians will be aware of gains from economies of scale.

The Education System should enforce the entrepreneurship vision from high school till tertiary education, therefore boosting the new generation mindset. Educational supports of human resource development as well as improvement of physical infrastructure oriented to invest in R&D. The priority has to change, from exogenous conditions such as enhancing agricultural sector to endogenous conditions, which can result in change of the current situation instead of being

⁴⁶ Research and Development

always the input for other economies. Thus, the rational use of natural resources becomes one more tool to develop our economy but not the only tool.

The correct course of action to improve doing business in Peru should start by fixing those negative procedures displayed in chapter 4. Also, we could switch to investment driven economy⁴⁷ through efficiency in producing standard products and services. In other words, Governments policies have to strengthen the role of Mypes not only by fixing the administrative system (Table.4) that currently affects SMEs but also allowing Mypes to participate in training courses through organized institutions providing them the knowledge to insert qualified people into the market. Therefore, with new information they could understand that is not enough only offer basic factor conditions (Factor-Driven Economy) such as low cost labor and unprocessed natural resources as a competitive advantage through exports. In other words, Mypes could understand the importance of being formal, efficient and competitive. Consequently, SMEs will request technology (ICT) that will be accessed through licensing, joint venture and FDI. That is to say, the evolution of Mypes towards strong national firms into domestic market as well as foreign market is feasible as long as policies enable the friendly environment equally for everyone. Therefore, the creation of doing-business culture has to start from the appropriate Government policies, else the current situation makes firms pay high taxes while new entrepreneurs always remain behind the curtain of informal business. The implementations of those reforms need to be sensitive toward national circumstances.

In conclusion, It is advocated to promote the reform by the State, eliminate bureaucratic barriers to all public entities within 3 months, simplify the tax system, establish a flexible legal framework, give benefits to the employee but not

⁴⁷ Efficiency in producing standard products and services is the dominant source of competitive advantage. It means product and competitive products become more sophisticated.

generating high cost for entrepreneurs, improve education as well as promotion of training provided by encouraging innovation through technological advances, and improve health.

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