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SMEs, TRADE AND DEVELOPMENT IN AFRICA

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SMES, TRADE AND DEVELOPMENT IN AFRICA^{*}

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Abstract

African Small and Medium Enterprises (SMEs) make significant contribution to economies of individual countries. They contribute to employment, engage in regional and global trade, attract investment, and are a source of livelihood for many. But many challenges hamper their growth and development. This paper shines a spotlight on African SMEs attempting to internationalise through trade and other foreign linkages. It does this by seeking answers to four interrelated questions touching on clusters and value chains as enablers of African SMEs internationalisation; support institutions facilitating SMEs' internationalisation; contribution of internationalised SMEs to sustainable poverty reduction and employment; and main bottlenecks that beset African SMEs in their quest to internationalise. It emerges that SMEs account for a slightly higher percentage of employment compared to large enterprises. When this employment emanates from internationalising SMEs, there is a high likelihood that it leads to sustainable development. It also emerges that African SMEs seem to be dynamic and have potential for greater internationalisation. Clustering and value chains hold opportunities to enhance this process. Similarly, concrete measures such as improved infrastructure, transport, access to finance; removal of non-tariff barriers at border points; and putting in place efficient processes are needed to facilitate greater SMEs participation in regional trade. All these go hand in hand with the need to ensure expanded representation of SMEs in regional and global trade negotiations.

JEL Classification: F14, L15

Keywords: trade, prices, SME, internationalisation, value chains, clusters

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Introduction

Small and medium enterprises (SMEs) are undeniably important in the global economy. African SMEs contribute to employment, engage in regional and global trade, attract investment, and enable many people to enhance their livelihoods. Yet SMEs face many challenges, and governments, even when they want to provide a supportive environment for their growth and development, often fail to do so effectively. This is in part because of the heterogeneous nature of the firms themselves, and in part because at least some of the issues the SMEs face differ from those of larger firms.

This paper pays particular attention to SMEs that are attempting to internationalise through trade and other foreign linkages. The paper addresses four questions:

1. How do African SMEs use clusters and value chains to link with foreign players and external markets?
2. How do support institutions facilitate the internationalisation of African SMEs?
3. What is the contribution of internationalised SMEs to sustainable poverty reduction and employment?
4. What are the main bottlenecks to SME creation, growth, and connectivity to external markets in Africa?

The paper is divided into sections. Section 1 provides the background for the study by describing both the nature of enterprises in Africa and their level of regional and global intergration. Section 2 deals with theory, especially for the internationalisation of African SMEs. The next three sections address the questions directly. Section 3 examines how foreign players link SME clusters and/or value chains to external markets. Section 4 discusses the role of support institutions in facilitating internationalisation/international activities. Section 5 investigates the contribution of internationalizing SMEs to sustainable poverty reduction and employment. Section 6 examines the bottlenecks to the internationalisation of African SMEs'. Finally, section 7 summarises the discussion and draws conclusions.

1. The nature of enterprises in Africa

1.1 Enterprise Structure in Africa

The African enterprise structure can be analysed in many ways. UNCTAD (2013) has identified five distinctive features of Africa's enterprise structure: (a) high and rising informality; (b) the small size of African enterprises; (c) weak inter-firm linkages; (d) the low level of competitiveness; and (e) the lack of innovation capabilities. Our focus on SMEs, Trade, and Development makes issues of firm size and ownership, linkages, competitiveness, and internationalisation most important considerations. We do not ignore innovation or levels of informality, but treat them as closely linked to our main concerns.

The first feature of African enterprise structure concerns firm size, ownership, and activities. Broadly, African firms tend to be small, owned by indigenous Africans, and engaged in trading and service activities. Size is widely recognised as an issue because of the inability of many firms to take advantage of scale economies (UNCTAD, 2013), yet measuring size is itself a problem because there are no agreed size classifications. Researchers, country statistical offices, and international organisations use different classifications. Although many use employment as the basic measure, some countries prefer categories that combine employment with some financial measure. For this paper, which attempts to cut across countries, we have adopted the classification used by the World Bank Enterprise Surveys (Enterprise Surveys (<http://www.enterprisesurveys.org>), The World Bank). According to this classification, microenterprises have fewer than five employees while small firms have between five and 19 employees. Many micro and small firms are 'informal' in the sense that they do not comply with at least some of the regulations that apply to their activities. As firm size increases, the likelihood for being formal rises. Medium enterprises have between 20 and 99 employees while large ones have more than 100 employees. The combined category of small and medium enterprises contains firms with between five and 99

employees. Nevertheless, we have also made reference to published materials that use different categories.

SMEs make significant contributions to African employment and economic output. For example, Table 1 shows the contribution of SMEs and large firms to employment. Note that the proportions change with rising country incomes. Africa and low-income countries in general show the largest employment shares in the small enterprise category, and this diminishes for lower middle income and high income countries. Furthermore, in Africa and low income countries generally, the share of employment attributable to SMEs equals or exceeds that for large firms (Ayyagari et al., 2014). SMEs account for 48.7 percent of employment in Africa, compared with 48.3 percent for large African firms (see Table 1).

Country Group	Size Class by No. of Employees			
	Small: 5-19	Medium: 20-99	SME: 5-99	100+
Africa	21.51	27.23	48.74	48.31
Low income countries	22.52	28.32	50.84	44.20
Lower middle income countries	17.89	25.61	43.50	51.06
High income countries	13.83	31.53	45.36	54.34

Source: Ayyagari et al., (2014)

Firms of different sizes also make different contributions to GDP, but reliable estimates of current contributions for the African continent as a whole are difficult to find. An often-cited estimate, based on UNIDO data of the 1990s, states that SMEs represent over 90% of private businesses and contribute more than 50% to GDP in Africa (UNIDO, 1999). It is not clear how much these percentages may have changed in the past 15 years. South African statistics, which may not be representative of the Continent as a whole, suggest that there may have been little change. For example, a recent study estimates that 91% of formal business entities in South Africa are SMEs and that these SMEs contribute over 50% to GDP and over 60% to employment (Abor and Quartey, 2010).

Although indigenous Africans own the largest number of firms in most countries, their firms tend to be smaller -- often one or two person informal businesses -- and involved in trade or service activities rather than manufacturing or mining (Pedersen and McCormick 1999). Ethnic minorities own many large-scale firms in Africa (McDade and Spring, 2005; Pedersen and McCormick, 1999). Minorities, such as Asians, Syrians / Lebanese and Europeans predominate in large businesses, while indigenous Africans own a third or less of large industrial firms even though exact proportions vary by country. This is supported by Ramachandran (2007), who found that in South Africa many of the black-owned firms are mostly informal, unregistered, with less than ten employees and operate in the margins of the private sector. Conversely, ethnic minorities dominate the formal business sector comprising larger, registered, or medium-size businesses. Notably, indigenous firms enter the market at a significantly smaller size than minority-owned businesses (Ramachandran, 2007). In East Africa, and probably in Africa as a whole, both immigrant minorities and indigenous peoples tend to create strong social bonds within their ethnic groups. This creates social networks that can, under certain circumstances be transformed into supportive business networks (McCormick and Kimuyu, 2007).

African economies have different sector distributions and different organisational structures. Mining appears as the most important sector in Africa, with exports of 'crude petroleum oils and oils obtained from bituminous minerals' accounting for nearly half (49.2%) of African exports in 2012 (AfDB 2014). There is, however, considerable variation by country. Fifteen out of 54 reporting countries have petroleum as their

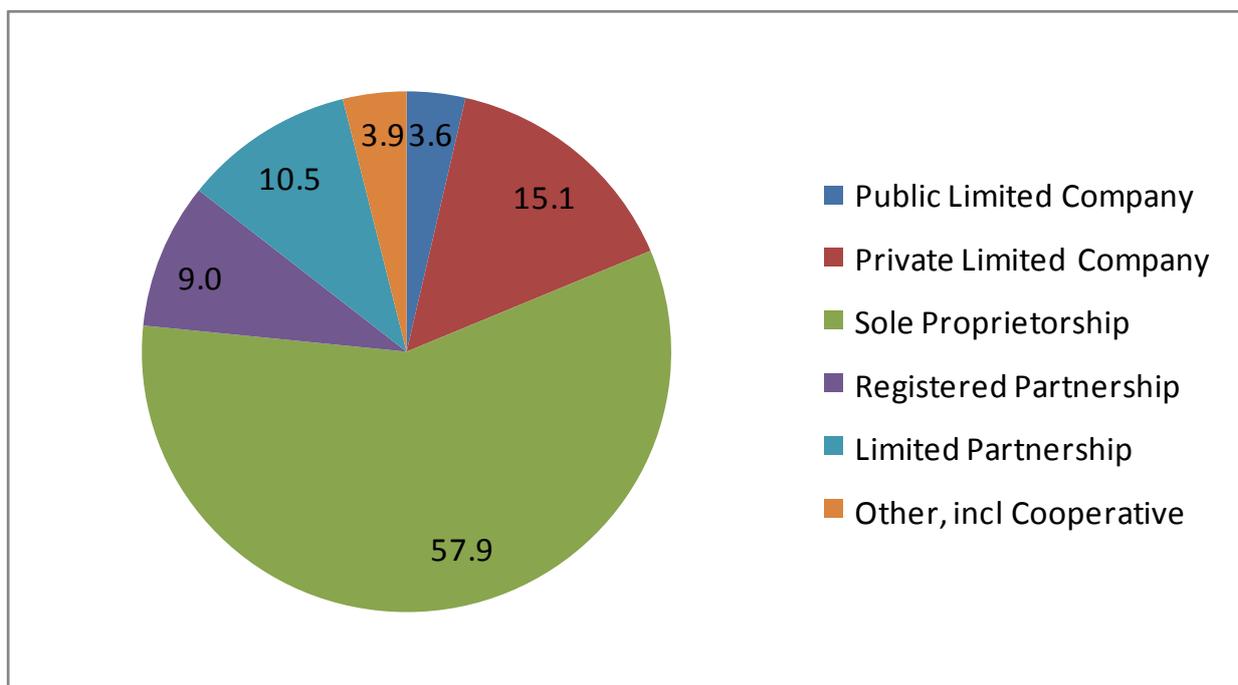
number one export, five countries list it as number two or three, but for the remaining 34 countries petroleum does not feature at all in their top three exports.

Organisationally, African enterprises can be segmented into individual enterprises, partnerships, private limited companies, and cooperatives (See Figure 1). Most formal-sector firms are sole proprietorships, followed by partnerships and private limited companies. Public companies are a tiny minority and are mostly larger firms. Among the 'others' are cooperatives.

According to Stampini et al., (2011), the private sector in Africa accounts for about 66 percent and 80 percent of total investments and consumption respectively. Notably, non-oil exporting countries have relatively large private sectors. Compared to the private sector, State Owned Enterprises (SOEs), also called parastatals in many African countries, have fared dismally. In particular, SOEs in infrastructure development sector have a long history of poor performance (ESMAP, 2005). Some of the best performing SOEs have been Ethiopian Airlines, the Kenya Tea Development Authority, and Sierra Leone's Guma Valley Water Company but the poorly performing ones are the majority (ESMAP, 2005). Consequently, since the 1990s, most African governments have focused on commercialization; privatization as well as Public Private Partnerships (PPPs) in the management and financing of SOEs.

Figure 1: Organisational Structure of African Firms

Source: Own analysis using World Bank Regional Enterprise Survey data



Large cooperatives are mainly found in 'traditional' sectors like credit and agriculture while the small ones are organised around the relatively new activities such as handicraft distribution, manufacturing, transport, and social services. In some countries, e.g., Ghana, Egypt and Kenya, agricultural cooperatives are diversifying to savings and credit (Develtere, 2009). In Rwanda, so as to meet tourist SMEs high product and service standards set by local standards in the tourism sector, the country has been successful in

setting up community tourist cooperatives owned and managed by members of the local community in all tourist locations in the country (WEDF, 2014). Thus cooperatives are increasingly becoming market driven and responsive to changing circumstances and provide strategic platforms for engaging with various stakeholders such as financial institutions as well as the state.

Although the distinction is often unclear, African enterprises are sometimes categorised in terms of formality. The difficulty is that formality is a concept that is inherently multidimensional and best measured on a scale, rather than as a dichotomous variable (McCormick, 1987). Many enterprises exhibit both formal and informal elements with regard to premises, taxes and regulatory compliance. Theuri's (2012) description of informal units as owned and operated solely by individuals or in partnership with other members of the household and found outside the formal private sector and partly outside state regulation best fits micro enterprises, although some of these can be categorized as SMEs. According to Theuri (2012) many such firms tend to operate in market niches not served by the formal sector and have minimal linkages with other sectors of the economy (Theuri, 2012). Other so-called 'informal enterprises' are, however, main players in their sector. For example, in many African cities paratransit vehicles (called variously minibus taxis, matatus, daladala) are the leading providers of public transport (Behrens, McCormick, and Mfinanga 2015).

1.2 Firm Interactions

African firms, including SMEs, do not exist in isolation, but interact with other firms including suppliers, service providers, customers, and collaborators. Recent literature provides two important models for understanding such interactions: the enterprise cluster model and the value chain model. Both are seen as relevant to the integration of African SMEs into regional and global markets.

2. Regional and global integration of African SMEs

African countries are increasingly integrated into the world economy and the economies of their various regional neighbours. This integration is marked by increasing market-based trade and financial flows, as well as the harmonisation of national institutions with those of the regional and global economies.

International trade and foreign direct investment (FDI) are important signs of integration and, some would argue, are drivers of productivity change (Sachs and Warner, 1995). According to the African Development Bank (2014, p. 48) external financial flows play an increasingly important role in Africa's development and economic growth prospects. Not only did such flows quadruple between 2000 and 2012, but the increase is projected to continue. Both trade and FDI are included in this increase. The main destination for FDI remains resource-rich countries, but manufacturing and services are attracting an increasing share of the external financial flows. The precise extent to which SMEs are included in these financial flows has not been well documented, but as will be suggested in subsequent sections, their potential for participating in external trade and benefiting directly or indirectly from increased foreign investment certainly exists.

As important as external financial flows are, they are not the whole story of African global and regional integration. Institutions are fundamental to development (North, 1990; Rodrik et al., 2004). More specifically, the ability of national, regional, and global institutions to interact harmoniously is the essential foundation for Africa's economic transformation and sustainable socio-economic development (UNECA, 2013). In its recent assessment of Africa's progress towards regional integration, the United Nations Economic Commission for Africa noted that Africa has put in place functional regional economic communities (RECs) as building blocks for a future African Economic Community, but pointed out that for the enlarged African market to be fully effective, it needs to be accompanied by harmonisation of its economic institutions. The study examined institutional issues such as trade facilitation measures, rules of origin, proposed continental financial institutions, and the current state of information and communication technologies (ICT) with the aim of achieving harmonisation of rules and regulations in order to promote further integration (UNECA, 2013). In each area, successes and challenges were identified, but as in many such studies, the actual and potential impact on SMEs were not charted separately.

Despite movement towards regional and global integration, challenges remain. In particular, according to the African Development Bank, a remaining challenge lies in the implementation of policies formulated in the recent past, a process that will require political resolve and heightened institutional capacities (AfDB, 2014). The Bank points particularly to issues of regional infrastructure, regional migration, financial integration, and regional value chains as matters needing considerable attention. Against this backdrop, it should not be surprising that African SMEs are yet to fully exploit the potential of integration. In fact, SMEs in Africa appear to lose out on the potential benefits of integration. Intra-African trade remains very low despite its huge potential in fast tracking development in the continent. Ancharaz et al. (2011) attribute the under-developed intra and inter-regional trade to a host of factors including lack of product diversification, low trade complementarity, poor and unreliable infrastructure (power, transport and communications) and complex customs procedures. Similarly, integration is demanding both financially and managerially. Firms must not only be able to meet international standards but also protect in-house intellectual property. For this reason, the role of the governments in helping SMEs overcome possible constraints to integration through trade facilitation is critical. Importantly bringing down transaction costs and waiting times at border crossings are equally crucial to economic integration within Africa. Arguably more and easier intra-Africa trade may act as a spring board for increased business especially between African SMEs and the rest of the world.

González (2013) argues that many African countries have benefited from rising foreign direct investment (FDI). The FDI emanates from Europe, South, Central and East Asia as well as Sub Saharan Africa (SSA). A case in point is the Chinese FDI to Sub-Saharan Africa (SSA) which rose from USD 1.5 million in 1991 to USD 61 million in 2003 while in 2006 approximately 700 mainly state owned Chinese enterprises were operating in large scale resource projects in Africa (Kaplinsky and Morris, 2009). The Chinese FDI is however found to play a negligible role in the development of domestic suppliers and labour through linkages. This is because Chinese firms usually rely on their own equipment, machinery and even workers. This generates marginal linkages to domestic firms in the host economy (Amendolagine et al. 2013). Apart from this, there is growing evidence that many foreign companies repatriate their profits thus denying many African countries the needed capital to develop their economies (Asongu, 2014; Fevrier, 2014).

Little attention has been paid to Africa's outward FDI, possibly because it is dwarfed by FDI into African countries. Nevertheless, we know of firms that have invested elsewhere. Most of these are large firms, such as banks, large-scale millers, fish processors and dairy firms. The extent to which SMEs set up production and/or distribution facilities beyond their borders are only partially understood.

3. How do foreign players link with local SMEs through clustering and value chains?

Producing firms internationalise when they import raw materials, export their final products, and/or otherwise create networks with foreign firms. The ability to internationalise depends not only on the external conditions, but also on a firm's own strategy and resources (Hagen et al. 2012; Balboni et al. 2013). Internationalisation can be synonymous with globalisation or it can indicate forays into neighbouring countries. Although it appears that a combination of clustering and links to global or regional value chains may promote internationalisation, the nature of the links between size, clustering, capabilities, and internationalisation remain obscure.

The integration of individual firms and whole sectors into the world economy can be a result of the firm strategies of individual firms or of their participation in industrial clusters and/or global or regional value chains. The two often go hand-in-hand, with clustered firms forging links with foreign individuals and firms in a process of internationalisation. Nevertheless, the two are conceptually distinct. A cluster is a sectoral and spatial concentration of firms (Schmitz and Nadvi, 1999; McCormick, 1999), while a value chain is a representation of a process of moving a product from initial idea to the distribution of the final good or service to its customers (Gereffi, 1994). A cluster is a physical entity that can be seen and touched. A

value chain is a tool for understanding the flows of knowledge, goods, and support services needed to bring a product to market (Kaplinsky and Morris, 2001). In the following sections we first discuss clustering and value chains separately and then look at how in practice they are often combined.

3.1. Clustering and Internationalisation

The early literature on industrial clusters emphasised the potential of clustering to achieve collective efficiency, a term used to cover the capturing of benefits from external economies and joint action (Schmitz, 1995). The main focus of such cluster analysis was usually the producers, although it was acknowledged that vibrant clusters also contain suppliers, service providers, and traders.

Clustering facilitates internationalisation by enabling producers to become more efficient, and thus to compete better in global and regional markets, and by providing them with access to those markets. Efficient production and distribution is usually essential for export competitiveness. For SMEs clustering can lead to greater efficiency and expand market access (Schmitz and Nadvi, 1999; McCormick, 1999). Often, however, the market access generated by SME clusters is improved access to domestic markets and some access to buyers from neighbouring countries which results in 'passive' exports. For example, artisans in Nairobi's Kamukunji metalwork cluster were frequently visited by buyers from Ugandan construction companies (McCormick, 1999). Likewise visits to Dar es Salaam revealed the presence of Kenyan products – weighing scales and beaded sandals, to name only a few – that had been bought in Kenya and carried by traders across the border. The extent to which SMEs in clusters become active exporters or begin to set up production facilities abroad is, however, largely unknown.

The ability to overcome growth constraints and compete in distant markets is, however, not an automatic outcome and instead requires among other things connection to sizeable distant markets and where trust sustains inter-firm relations (Schmitz and Nadvi, 1999). In other cases, internationalisation is an extension of local markets. Producers of weighing scales in Nairobi's Kariobangi cluster and makers of beaded sandals in Kariokor export their scales to similar markets in Dar es Salaam. This is internationalisation of a different sort.

Clustering is especially useful in poor regions seeking to industrialise and which need to mobilise unused resources effectively, as it facilitates specialisation and effective investment in small steps. Clustering breaks down investment into small risk-able steps whereby one enterprise creates a foothold for the other. Ladders are constructed which enable enterprises to climb up and grow through a process in which enterprises create for each other possibilities for accumulating capital and skill (Schmitz and Nadvi, 1999). The process, however, is not automatic nor is spatial proximity always necessary for the building of regional clusters. The small size of markets, over-supply of labour, and weak institutions characteristic of many African countries mean that the collective efficiency model does not always work as expected (McCormick, 1999). As a result clusters can languish with inefficient production as they continue to cater mainly for local markets.

Evidence supports the assertion that under favourable policy environments, clustering promotes SMEs growth and internationalisation. Given the financial market failures, as well as pervasive labour and technological market failures, clustering provides a welcome alternative route for SMEs development and is potentially a less costly avenue for policy support because clustering facilitates the mobilisation of financial and human resources leading to the gains of collective efficiency (Oyeleran-Oyeyinka, 2006). Clustering also promotes different types of inter-firm linkages and is identified with diverse forms of social networks associated with personal ties and the notions of trust and reciprocity in competitive behaviour.

Some would argue that Information Communications Technology (ICT) has made the spatial proximity characteristic of industrial clusters unnecessary. Development in ICT has certainly helped reduce the problem of isolation of SMEs in Africa and elsewhere. Nevertheless, there still seems to be a role for spatial proximity. Although ICT allows people to communicate, the trust needed for close business dealings almost always requires some face-to-face interaction. Furthermore, spatial proximity offers some benefits that are hard to replace with ICT. In a study of small scale manufacturing clusters in five African countries, Oyeleran-Oyeyinka (2006) found variations regarding the role of spatial proximity. In particular, the benefits of geographic proximity included facility sharing, easy access to information and product markets as well as training opportunities. Some clusters collaborated more with foreign firms while others developed

greater inter-firm linkages among themselves. With regard to support, the private sector was more instrumental while the central or local authorities provided little support beyond the provision of basic amenities. Supportive linkages with knowledge institutions is similarly lacking and could be a major factor in the lack of innovation observed in many small-enterprise clusters. In a review of literature on four knowledge-intensive metalworking and automotive clusters, Taura and Watkins (2014) found weak linkages between the enterprises and knowledge repositories such as universities, science parks, and R&D centres. This leads to replication and exchange of the same local knowledge which is a major constraint to innovativeness in African clusters. These examples highlight the fact that although the clusters themselves are not necessarily planned interventions, both the state and knowledge institutions can play a positive role in enabling them to grow and/or move to higher levels of technology.

3.2. Value Chains and Internationalisation

Becoming involved in global or regional value chains seems like a sure route to growth in exports and ultimately to higher incomes. Most SME producers, by selling into local markets or engaging in passive exporting, participate in domestic value chains. Some of them later adopt an export strategy hoping for wider markets and greater profits. In many cases, such a strategy is successful, but in some it fails to improve incomes or even results in losses.

Box 1. Key Value Chain Concepts	
1.	Value: added at every stage, but in differing amounts
2.	Chain: Design, supply, production, distribution
3.	Geographic reach: Global, regional, local
4.	Governance: Power of some actors over others in the chain
5.	Types of Chains: Buyer-driven; Producer-driven
6.	Standards: Rule for measuring a product or process
7.	Upgrading: Improving products and/or processes; moving to a higher level chain.

A value chain (VC) describes the full range of activities required to bring a product or service from conception, through the different phases of production (involving a combination of physical transformation and the input of various producer services), delivery to final consumers, and final disposal after use (Kaplinsky and Morris, 2001). Value is added to the product at every stage, but often in differing amounts (see Box 1). For example, in some value chains, the design or conceptualisation of the product is the key stage for creating value, while production is a routine assembly operation that adds less to the product's final value. Value chains can be distinguished according to their geographic reach (see Box 1). Global value chains (GVCs) have received the most attention, but SMEs are likely to begin their foray into external markets through regional value chains (RVCs).

The standard discourse on value chains divides them into two broad groups based on the location of the organising power in the chain. Buyer-driven chains are organised or 'governed' by the retailers or branded buyers who usually provide the designs and coordinate the supply and production functions. Producer-driven chains, on the other hand, are governed by the producers who often subcontract to specialised suppliers for the various parts that go into a finished product (Gereffi, 1999; Kaplinsky and Morris, 2001). Using recent research on commodities in Africa, Kaplinsky and Morris (2014) have developed a different categorisation of value chains based on whether the chain follows the classic sequential steps of value addition or undertakes production in parallel specialised stages that only come together in the final product.

They call former 'additive' value chains, and the latter 'vertically specialised' chains. The new terminology provides one more handle for understanding value chains and using value chain analysis to develop policies that enable participants to reap their benefits.

As a firm begins to look outward, it may be eyeing wider markets for its products, looking for better raw materials, seeking new equipment, or searching for technological assistance. Any or all of these may form parts of the firm's internationalisation strategy and may lead to some sort of participation in global or regional value chains. Globalization has enhanced enterprise growth and internationalization through re-organization of production and outsourcing. Such re-organization allows SMEs to engage in global trade without having to build proficiency in all stages of the production chain. Links to multinational firms can be important. Over fifty million SMEs in Africa rely on trade opportunities beyond their national borders more so because trade takes place within value chains built around large multinational firms (González, 2014). For example, the high degree of co-operation between Toyota South Africa (TSA) and its suppliers is partly responsible for the improved small-firm efficiency arising from information flow, technology transfer and learning opportunities (OECD, 2008). In such cases, participation in GVCs helps firms expand markets, raise productivity and attain financial stability. The clothing and footwear industries offer many examples of improved access to global markets (McCormick et al. 2009; Kaplinsky and Morris, 2009). A firm's first participation in such chains is often as a subcontractor, producing for a branded 'buyer' (Gereffi, 1999; Gibbon, 2005). Many subcontracting firms are very large, but others such as specialist producers and freelance designers, could be classified as SMEs (McCormick and Schmitz, 2002).

Outside of direct production, SMEs participation in global value chains (GVCs) offers both opportunities and challenges. The participation can be as a supplier of raw materials, packaging, or services to producers within the country or in other countries. Producers of clothing will, for example, often procure packaging materials locally. This gives local manufacturers of packaging an opportunity to gain entry into a global or, more likely, a regional chain. In other cases, the opportunities will be for the provision of services. Factories need a wide range of services, including security, laundry, logistics, accounting, and many more. Such opportunities, which have been created by the fragmentation of global production chains, can ease entry of African SMEs into international markets (OECD, 2008; Schmitz, 2006).

SMEs may also benefit from the investments in supplier's competencies made by their global buyers as well as unintended knowledge spillovers that enable local producers to meet high product specifications (OECD, 2008; Schmitz, 2006). On the other hand, trade liberalization may work in favour of well-established foreign manufacturers at the expense of local SMEs. Lunati (2006) observes that only a limited number of SMEs are well prepared to deal with the increased competition encountered in global markets thus limiting those who benefit from opportunities opened up by globalisation.

Certain factors still constrain African SMEs participation in GVCs. Some scholars identify governance and power relations within the chain as a major challenge (Humphrey and Schmitz, 2000; Navas and Aleman, 2011), arguing that some dominant firms may prefer weak counterparts to potential competitors. Indeed empirical evidence shows that an individual SME benefits less from participating in GVCs if certain dominant firms exercise power and defend their market positions by discriminating against other members of the chain.

Many firms, even those that are internationalised in some of their activities, benefit from participating in regional value chains (RVCs). UNCTAD (2013: 92) argues that 'regional markets permit domestic firms to learn, meet product standards, and develop the production capabilities required for successful participation in global production networks'. For the case of Kenya, Kamau (2010) observed that the African regional market was gaining prominence among local clothing manufacturers. He noted a number of important characteristics of firms in this chain, namely that in contrast to those serving only the local market, firms in RVCs used marketing representatives, sold higher value goods, and marketed under their own brands. Efforts on the part of regional economic trade areas to harmonise trade regulations should only improve the prospects for RVCs.

Further research is clearly needed in this area. Messner (2004) suggested a methodology for bringing together the cluster and value chain frameworks. Nevertheless, it appears that little empirical work combining the two approaches has been done, but some useful theorising supports a recent systematic synthesis of qualitative research on business clusters (Rauch et al., 2014).

4. Support institutions and African SMEs

Internationalisation can be daunting to the typical SME. As already indicated, many SMEs rely on passive exporting, probably because they lack the financial resources, skills, market information, or networks to initiate exporting alone. Support institutions seem to play an important but still somewhat limited role in the internationalisation of African SMEs. The main institutions capable of providing support are Government, regional actors, business or sectoral associations, private-sector firms such as banks and insurance companies, and knowledge institutions.

A number of African governments have devised measures aimed at reducing the gaps in financial resource flows to SMEs. At least two approaches can be identified. The first is an effort on the part of Government to build the country's general competitive advantage. Rwanda has done this. Rwanda's ambition is to become Singapore in Africa, i.e., the financial hub of the Central and East African region (Ulrich and Thomas, 2014). Rwanda, a former Belgian colony, joined the East African Community in 2007, and has begun promoting the use of English in schools, government, and business. The Rwandan government has aimed at low criminal activity, the protection of private property and a stable and transparent legal system, effective administration, and low corporate tax rates in order to position Rwanda as a regional hub that can attract foreign investment into basic industries and create export opportunities for its products.

Other countries have focused more on specific supports for fostering exports of particular types. For example, a search for trade support institutions in Kenya turned up a list 18 organisations, including the Export Promotion Council, Export Processing Zones Authority, the Horticultural Crops Development Authority, and the Coffee Board of Kenya. Some of the measures include setting up special credit guarantee schemes and development banks. The Kenyan government for instance has set up the Growth Enterprise Market Segment (GEMS) at the stock market (RoK, 2014). The introduction of GEMS means firms can be engaged much earlier in their development and offered an alternative option to obtain the requisite capital for their expansion locally or in the regional markets.

In addition, the recent developments in the financial sector such as proliferation of microfinance institutions and government credit schemes for women and youth signify a new financial support environment for SMEs. Governments, often through their Ministries of Trade and Industry, offer some services to domestic companies wanting to trade or invest abroad, or to source supplies or equipment on the global market. The range of possible services is great, including those aimed at developing export capabilities, undertaking market research, assistance or advice in developing or expanding export markets, and undertaking the commercial tasks associated with exporting. For instance, it is reported that in 2013 the Kenyan Export Promotion Council provided capacity building programs for SME exporters and facilitated business enterprises in developing new products, which were test-marketed through participation in trade fairs and exhibitions. In addition, about 693 SMEs were trained on export trade and export awareness at country level enabling them to understand the requirements of getting into export business (KNBS, 2014). In Tanzania, the government established the Export Guarantee Fund with the Bank of Tanzania aimed at guaranteeing exporters to access credit from commercial banks geared towards promoting exports from SMEs (Wineaster, 2011).

Regional actors, such as the East African Community (EAC), the Southern African Development Community (SADC), and the Economic Community of West African States (ECOWAS) also provide information and services. For instance, so as to promote regional cooperation, the East African Community commits itself to prioritising investment and industrial development. This is done through facilitation of the development of small and medium scale industries including subcontracting and other relations between larger and small firms. In 2009, the Community commissioned a study to develop alternative strategies for the promotion of the SME sector with a view to raising the survival and growth rate of the enterprises (Ernst and Young, 2009). The study uncovered a myriad of problems facing the sector. But it also noted significant progress especially in the policy environment and access to financial services across all the countries apart from Burundi.

Similarly, business associations and specialised private sector bodies can play an important role in specific sectors. Firms often find it advantageous to join together in networks, linkages and subcontracting

relationships. Such external relationships often enable firms to do things that would not be feasible alone (McCormick and Kimuyu, 2007, Oyeleran-Oyeyinka, 2006). Business associations are a good example. They are formed for the joint benefit of the members such as lobbying the government for policies and programs. Service oriented associations provide training, market information, directory services, industry research, technical advice, and a host of other services to their members and sometimes outsiders. Development partners working together with business associations have been known to provide a range of services including capacity building, advocacy, and financial support in the formulation and implementation of policies and programs. Examples include the Danish International Development Assistance (DANIDA) Guarantee Fund under Tanzania banks such as CRDB, which targets SMEs (Wineaster, 2011). Similarly, the Tanzania Export Revolving Fund provided by the government of Netherlands in collaboration with the UNDP largely assists genuine and potential exporters to achieve better results from eligible, worthwhile export activities. Horticulture and handicraft were selected to be pioneer beneficiaries (Wineaster, 2011).

Sectoral associations are extensions of these groupings. For example, the East African Grain Council (EAGC) is a membership-based organization comprising and representing major grain value chain players and stakeholders which include but not limited to producers, input suppliers, grain traders and processors. (<http://www.ata.gov.et/wp-content/uploads/Eastern-Africa-Grain-Council.pdf>). EAGC members benefit from their market information services, warehouse receipt system, and efforts to improve policy across the region.

Support from financial institutions is paramount in ensuring SME growth as all businesses need capital. McCormick and Kimuyu (2007) outline four basic elements of finance systems found in most countries. These are capital markets, banks, insurance, and other formal institutions; supplier credit; small-enterprise credit programs; and informal sources. On the positive side, there are now many banks that have put in place specific programs targeted at exporting SMEs. But one still wonders how effective the overall financial infrastructure is in supporting enterprises in Africa? Oyeleran-Oyeyinka (2006) argues the problem seems to be the accessibility of financial institutions rather than the availability and accessibility of funds. He notes that enterprises in most African countries have low access to finance as most countries, apart from South Africa and Mauritius, seem not to have an efficient structure of financial institutions providing short and long-term capital to SMEs.

Private equity and venture capital is a useful illustration. Private equity and venture capital is an important avenue for SMEs financing particularly in providing capital for start-ups and growth. Apart from providing capital, private equity and venture capital also bring to SMEs the much needed technical skills. However, Divakaran et al., (2014) say that the market for SME private equity and venture capital in many developing countries represents a small fraction of the overall quantity of fund investment. They report that in 2011 there were about 16 active funds dedicated to East Africa, and, according to a survey by Deloitte (2012), there were 20 deals representing a total investment of \$188 million. However, the average transaction value per deal was more than \$10 million, meaning that SMEs that were seeking less than \$3 million to support their first stage of growth or expansion were largely overlooked. Although increased flows of private equity investment could help to create, deepen, and expand SME growth in developing economies, the vast majority of private equity firms in such markets target larger or more established enterprises. They conclude that while the number of funds and fund managers is evolving, the fund management industry in emerging market regions such as Latin America and East Africa remains nascent.

Small and Medium Enterprises are consumers of knowledge in their daily operations. They are also constantly generating new knowledge and this need to be shared in their ecosystems. This demands for a supportive knowledge system that ensures knowledge generation, acquisition and transfer. This has led observers to call for models that facilitate industry, academic institutions and the private sectors to collaborate. In such models, the University produces advanced knowledge, venture capitalists provide finance and innovation network. In this way, transfer of knowledge and knowledge management to promote diffusion of ideas from universities adding value to the private sector through innovation is enhanced (Carlisle et al. 2013). Africa seems to be catching up in this process. Entrepreneurial universities are increasingly providing the catalyst for entrepreneurship and incubating business operations originated from innovations developed in the university. The University of Dar es Salaam in Tanzania is a good

example (Carlisle et al. 2013). In Kenya an example of a similar initiative is the Chandaria Business Innovation and Incubation Centre <http://www.ku.ac.ke/chandaria-biic/> at Kenyatta University. On the other hand, how these initiatives are effective in helping benefiting SMEs to internationalise needs further probing.

5. The contribution of internationalizing SMEs to sustainable development

Internalisation among SMEs is not only critical to employment creation but to the overall sustainable development of an economy. However, while SME internationalisation is happening in Africa, this internationalisation is below par calling for special attention to enable SMEs to unlock their potential and contribute more to the sustainable development of African economies. SME internationalization has attracted increased interest among researchers. In particular, attention has focused on the both the process and the contribution of internationalising SMEs to poverty reduction and employment creation. Thakkar et al., (2014) define internationalisation as a process of establishing networks of business ties in foreign countries through extension, penetration and integration. According to Jansen (2014), firms can internationalise in four ways namely: direct export; export through independent foreign agents; export through subsidiaries or establish production facilities in the export market. In other words, entry modes begin with exporting, turnkey projects, licensing, franchising, joint ventures to establishment of wholly owned subsidiaries (Thakhar et al., 2014). This trajectory is supported by findings that South African SMEs exported mainly to the regional bloc (SADC) before venturing out to the rest of Africa then later on to North America, Europe, Australia and New Zealand (SPB Alert, 2013). Arguably, prior experience in the domestic and regional market allows SMEs to develop the requisite capabilities for sustained internationalization (Damoah, 2011).

Empirical evidence shows that exporting firms contribute more to employment and incomes than non-exporting ones. For example, exporting African SMEs employ up to 17 percent higher and increase earnings by up to 12 percent higher than non-exporters (Martijn, 2010). Similarly, through rapid expansion and creation of higher income growth without skill-bias, exporting firms contribute to poverty reduction. According to Keskggn et al. (2010), SMEs contribute to a stable economic environment by reducing the structural inequalities and capital markets imperfections. However, the performance of African SMEs in international trade is less than satisfactory. On the one hand, some writers note that most exporting SMEs respond to opportunistic circumstances rather than long-standing relationships with customers (Jansen, 2014). It is also noted that there is a high failure and exit rates among exporting SMEs. Jansen, (2014) further notes that developing country SMEs not only exhibit high failure and exit rates, but are also less successful in sustaining trading relationships due to lack of capital, language and cultural barriers, internet access and competition from established firms. Osei-Bonsu, (2014) found that African SMEs are less likely to venture into international markets. Similarly, a South African study found out that 80 percent of SMEs derive less than 20 percent of their revenue from exporting while only 7 percent of manufacturers export all their production. On the other hand, results from the World Bank Enterprise Survey 2013 note that in Kenya, the percentage of Kenyan firms which export, directly or indirectly, has remarkably increased compared to six years ago. In 2013, 36% of firms exported at least 1% of their sales compared to 10% in 2007. In addition, the proportion of sales that is exported directly also increased, from 2% in 2007 to 11% in 2013 (Enterprise Surveys (<http://www.enterprisesurveys.org>), The World Bank).

Indeed, a number of factors constrain SME internationalisation in Africa namely access to finance, business and regulatory environment, trade costs, access to technology and skills among others (ITC and WTO, 2014; Okpara and Koumbiadis, 2009). Other constraints include competitive pressures from resource-rich foreign firms and governance of global trade (Mensah, 2012). However, the growing use of information communication technology (ICT) among African SMEs has helped them deal with information-related barriers. In particular, the internet is seen as useful in helping the SMEs facilitate global marketing, selling, risk assessment, finding and communicating with new customers, communicating with them and distributing products (Mori and Munisi, 2012). Access to the internet among rural SMEs on the other hand continues to be hampered by poor infrastructure on hand while lack of knowledge about the potential of e-commerce has hindered its adoption among others (Faloye and Akinkoye, 2013; Mpele 2014).

As WEDF (2014) clearly puts it, SMEs international competitiveness is shaped by a host of factors: their internal productive, innovative and managerial capabilities; their ability to connect with suppliers and engage in meaningful business transactions; and the business environment in which they operate. In

today's competitive world, policy makers, business associations and trade support institutions must work in unison to create conditions for SMEs to better integrate into regional and global value chains: improving the business environment as well as SMEs' capacity.

6. Bottlenecks for SME creation, growth

Although the contribution of small enterprises to equitable development and poverty is widely recognized, SMEs in developing countries continue to encounter a number of constraints namely regulatory; institutional; financial; access to non-financial inputs; and policy related constraints. This section explores these constraints in terms of SME creation, growth and connectivity to external markets in Africa while making propositions of how they may be eased.

6.1. Regulatory and institutional constraints

Regulation is a reality for all firms given that the conduct of business activities has to conform to certain legal norms. In particular, firms must seek permission and be licensed to operate as well as register their names and property. Equally, firms must follow official rules regarding taxation, labour, health and product quality standards. The purpose of regulatory framework is therefore to guide business-to-business and business-to-state relations; protect intellectual and other property; for contract enforcement and dispute resolution among others (World Bank, 2012). In other words, regulation not only sets clear and transparent rules necessary to ensure equal treatment of enterprises by public administration.

However, navigating regulation can be complex and costly in terms of both time and money. While some studies correlate a well-functioning business environment with higher SME density (IFC, 2006), there is evidence that excessive regulation burdens entrepreneurs and reduces their propensity to invest and innovate (World Bank 2010c; OECD 2010). Notably, the influence of regulation depends largely on the size of an enterprise such that SMEs are more constrained than large firms (Beck et al., 2005; Schiffer and Weder, 2001; Weichenreider, 2007; OECD, 2004). For example, cumbersome licensing requirements associated with starting a business not only have a strong correlation with SME creation but also create substantial opportunities for officials to extract side payments (Fjose et al., 2010).

While the ability to comply with high product standards improves a firm's chance of securing large contracts and subcontracts, many SMEs are unable to pursue this growth opportunity due to limited investment in human resources and modern production technology. Furthermore, unawareness about product standards and arbitrary introduction of new ones by inspectors complicate attempts at compliance. On the other hand, the rigidity of the labour market characterized by the difficulty in hiring and firing as well as the rigidity of working time has also constrained SME growth (Botero et al. 2004). According to Van Stel et al. (2007), labour market regulations depress measures of entrepreneurship by limiting the ability of the entrepreneur to adjust their workflow. In the absence of flexible employment regulations, entrepreneurs may opt against rapidly expanding their labour force in line with changing market conditions (Fjose et al., 2010).

Taxation impacts SME performance in terms of total tax liability, the number of taxes, and the method of payment. According to World Bank (2014), Africa is ranked poorly in terms of fiscal burden of regulation. For example, enterprises pay about 47 percent of commercial profit as tax against a world average of 41 percent. Entrepreneurs also spend 317 hours and make about 36 payments against world averages of 264 hours and 26 tax payments respectively. Although SMEs are exempt from Value Added Tax (VAT) which is considered irksome on account of the administrative tasks involved, larger firms often insist on VAT-registration for all subcontracting SMEs (UNCTAD, 2001). In consequence, non-VAT compliant SMEs are locked out of such lucrative subcontracts that offer opportunities for growth (World Bank, 2014). Moreover, Value Added Tax (VAT) is costly to administer, increases transaction costs and inhibits cash flow (McCormick, 1993).

While growth may bring certain benefits of legitimacy to firms such as securing public contracts, spread administrative costs, access to credit and opportunities for subcontracting (UNCTAD, 2010), cumbersome regulation can deter growth. For example, some firms may opt to remain small and invisible as a way of

increasing their options for regulatory avoidance. Moreover, medium-sized enterprises can be at a disadvantage if, having graduated, they face a significant loss of the special privileges afforded to micro and small enterprises (UNCTAD, 2010).

Although many costs of dealing with dense regulatory regimes are fixed, the payoff from doing so probably increases with scale of operations (Tybout, 2000). Consequently, the burden of regulatory compliance is disproportionately heavy on SMEs. In other words, large enterprises enjoy administrative economies of scale and often pass the burden of regulatory compliance down their supply chain to SMEs (UNCTAD, 2010). Therefore, besides imposing substantial entry costs which hinder SME creation, bureaucratic burden can also constrain growth or even lead firms to expand inefficiently by creating quasi-independent enterprises, each smaller than the threshold at which the tax and regulatory requirements are imposed (Levy, 1993). Some writers also argue that a combination of red tape, corruption and complex entry regulations provide SMEs with incentives to stay small and informal (Fjose et al., 2010). In other words, a weak business environment displaces activities from large, medium and small firms to the benefit of micro-enterprises (Aterido et al., 2009). The large informal sector in developing countries poses stiff and unfair competition to SMEs thereby constraining their growth (Khan, 2014). As Figure 2 from the World Bank Enterprise survey 2013 illustrates, the practices of the informal sector is a big constraint especially for enterprises drawn from Kenya.

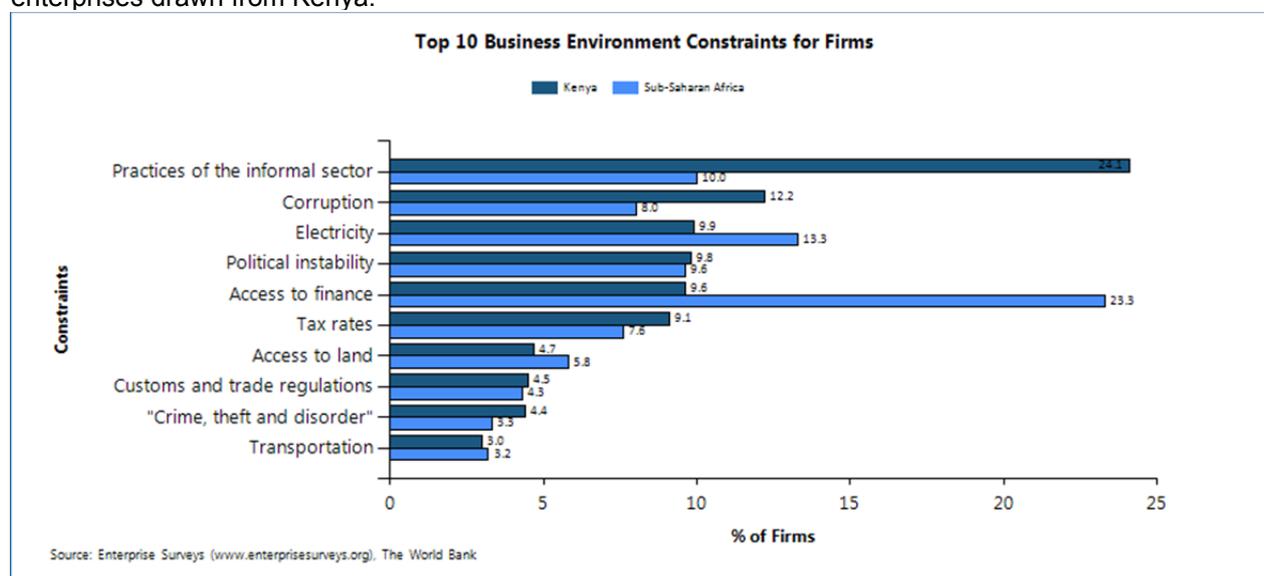


Figure 2 Top 10 Business Environment Constrains for Firms

Notably, concerns have also been raised regarding arbitrary or non-enforcement of regulations. In other words, even non-enforcement of certain regulations on the smallest businesses still has an impact. According to McCormick (1993), non-enforcement of regulations increases the uncertainty of the business environment. Similarly unpredictable costs of regulations have been found to more burdensome to SMEs in developing countries (Tybout, 2000). In other words, besides time and cost of compliance, unpredictability of law enforcement also matters.

Generally, improving the regulatory regime for enterprise development is a not a question of less or better regulation, but a regime characterized by strong institutions and low transaction costs (World Bank, 2013). In other words, regulation should accord protection to firms without being excessively burdensome. Indeed a number of African countries have put in place measures aimed at improving their business and investment climates. Much attention has focused on ease of starting and doing business through single business permits; enterprise training and incubation programmes among others. While all these measures are assumed to mitigate constraints faced by SMEs, their overall effect deserves empirical investigation.

6.2. Financial constraints

Enterprises require a variety of financial resources to start, to operate and to grow. Financial inputs include access to and cost of credit and banking services. Equally important also is access to and cost of

appropriate insurance services. Indeed, some studies positively associate availability of external finance with enterprise creation (Grunfeld and Green, 2007); enterprise growth (Dermirguc-Kunt, et al. (2008); Ayyagari et al. 2006; Beck et al. 2000; Rahaman 2011); and enterprise productivity (Buttler and Cornaggia, 2011; Gatti and Love, 2008).

However, there is evidence that access to finance for African SMEs is more difficult than large firms (Beck et al. 2006; Grunfeld and Green, 2010; Schiffer and Weder, 2001). For example, 48 percent of small enterprises identified access to finance as their major constraint compared with 41 percent and 34 percent of medium-sized and large firms respectively (Fjose et al., 2010). Similarly, some writers have noted the existence of a SME financing gap which constraints enterprise growth (Khan, 2014). In other words, while micro enterprises have some access to finance through microfinance, personal lending and money lenders, these sources of credits tend to be unavailable to SMEs (Fjose et al., 2010). Therefore as SMEs grow, they find themselves to be too large to be financed through micro-financing but too small to access full collateral based commercial finance.

Moreover, a number of factors conspire to limit SMEs acquisition of financial services. Firstly, is the inappropriate legal and financial regulatory framework that does not recognize innovative strategies for lending to SMEs (Memba et al. (2012). Secondly, most formal financial institutions perceive SMEs as high risk and commercially unviable and therefore should be avoided or only dealt with after meeting stringent conditions and at a premium price (Khan, 2014; Memba et al. 2012). The notion of high risk is reinforced by a number of factors such as lack of systematic business track and accounting records, financial illiteracy by promoters, severe governance issues which undermine accountability and lack of bankable collateral (Levy, 1993).

In spite of this, perhaps in recognition of the mentioned challenges, the financial landscape in many African countries seems to be changing in favour of the SME sector. This change has been fuelled by the proliferation of microfinance institutions; government credit schemes targeting youth and women; as well as entry of international NGOs. Similarly, most banks have also introduced financial products tailored to meet the needs of SMEs. Kenya is a case in point. The Kenya Commercial Bank (KCB) has a KCB *Biashara* Club brings together SMEs to learn, network and broaden their business scope (<https://www.kcbbankgroup.com/>). Through this product, the bank provides advisory services through management seminars and workshops. In addition, the bank organises regional and international business trips. In April 2015, it sponsored more than 105 *Biashara* Club members to an eight day visit to Israel to network and explore export/import markets and learn from successful peer business. In the same vein, to take advantage of the rising demand for financing by Kenya's exporting SMEs, a number of banks are readying themselves for this in several ways including borrowing from international lenders. Perhaps as a result of such interventions, firms' access to financial services in Kenya has remarkably improved since 2007 (Enterprise Surveys (<http://www.enterprisesurveys.org>), The World Bank). On average, 44 percent and 41 percent of Kenyan firms use banks to finance investment and working capital respectively as of 2013. The corresponding figures in 2007 were much lower at 23 percent and 26 percent respectively. Additional empirical studies are required to investigate the effect of the changing financial landscape on SME development in Africa.

Risk and uncertainty is a reality for all businesses. If not well managed, risk can substantially reduce enterprise growth (Elbers et al. 2003). For this reason, insurance has been found to have a very strong effect on the investment decisions of SME owners regarding growth and expansion. In particular, insurance decreases vulnerability to risks thereby encouraging entrepreneurs to make investments that bring about additional risks (Slater et al., 2009). Empirical evidence shows that protection against basic risks such as illness, work disability and death predisposes entrepreneurs to accept the additional risks that investments and growth efforts usually entail (Loewe, 2009).

Notably, the effect of risk is particularly pronounced for SMEs due to a number of reasons. SMEs operate in temporary structures in peripheral locations with no provision of utilities such as security, electricity and roads which expose them to the risk of theft, fire, and even demolition by local authorities. Despite their high risk exposure, SMEs are largely underserved by mainstream insurance companies. Although some micro-insurance products have targeted micro-enterprises, SMEs that have grown beyond micro enterprises face a gap as they are still too small to enjoy formal insurance services. Some authors have

found that risk is a significant constraint on SME growth. Consequently, SMEs employ diverse risk management strategies including staying small; maintaining flexibility by working in rent free quarters; using family labour and little capital; diversify their income rather than expand a single business; and preserve their assets unencumbered by debt (McCormick, 1993). While these are rational responses to a risky business environment, they may not only work against enterprise growth but also constrain emergence of a dynamic SME sector. Although these conclusions were done in 1993, it appears that they haven't changed much.

Inter-firm linkages and business networks have been suggested as ways of addressing some of the financial, technological and information imperfections. Some writers argue that African SMEs can get around market failures and lack of formal institutions by creating private governance systems in the form of long-term business relationships and tight ethnically based business networks (Biggs and Shah, 2006). Networks and inter-firm interactions enable members share knowledge; access vital resources and markets; increase bargaining power; facilitate collective efficiencies; and share risk (Humphrey and Schmitz, 2000; Loewe, 2013). Additionally, networks not only facilitate informal contract enforcement using the threat of social exclusion, but also provide mutual insurance assistance to smooth cash flows by circulating market and technological information.

However, the benefits of networks depend on the independence, strength and representativeness of business associations. For example, Loewe (2013) finds that network benefits are significantly reduced in many African countries where business associations are either controlled by the state or do not represent nor support their members' interests (Loewe, 2013). Similarly, ethnicity is often used to restrict entry into networks as well as certain business activities (Fafchamps, 2001 cited in Biggs and Shah, 2006). In other words, networks raise the performance of insiders but constrain growth of the excluded. Networks can also be examined using the state-business-relations perspective. For example, entrepreneurs with good personal connections to the government or influential people in the bureaucracy may get preferential treatment regarding registration, licensing, taxation, or a government tender that can ease market access and help expand the business (Loewe, 2007). In contrast, most SME owners without such connections are unable to influence decisions taken by the government or public administration. For them, unfair competition constitutes a high barrier to market entry and an obstacle to upgrading (Loewe, 2013). While literature suggests that most indigenous African SMEs are excluded from business networks (Biggs and Shah, 2006), this assertion requires empirical investigation in light of the emergence of many formal and informal business networks.

6.3. Constraints related to access to non-financial inputs

SME growth also requires a number of non-financial inputs such as physical, technical and marketing inputs. Some scholars argue that overall availability and the conditions for access to infrastructural resources such as transport links, energy, water and up-to-date information technology significantly influence SME growth (Loewe, 2013). Conversely, inferior infrastructure especially power outages lower returns and levels of private investment (Aterido et al. 2007; Dollar et al. 2005; Hausmann et al. 2008; Loewe 2013). For example, more than 50 percent of businesses considered reliability and cost of electricity as the most important challenge (Fjose et al., 2010; Hatega, 2007; IFC, 2006; Kauffmann, 2005; World Bank, 2010b). Besides Africa's low investment in energy generation against growing energy demand, electricity cost is almost twice as high as in Latin America and Eastern and Central Asia (Fjose et al., 2010). Energy problem in Africa is further compounded by overexploitation of transmission lines that cause problems of power outage. Youpes et al. (2008) associate slow economic growth to frequent power outage while other writers estimate that annual GDP growth would have been 1-2 percentage points higher if access to electricity had been more stable in SSA (Fjose et al., 2010).

Notably, the problem of access to reliable and affordable electricity appears to be dependent on enterprise size. Although the problem of access seems to hit larger businesses more severely due to their energy dependent manufacturing activities, SMEs appear to bear a heavier loss due to power outage than larger companies who have to a larger extent invested in alternative power sources such as diesel aggregates (Fjose et al., 2010; World Bank, 2008). In order to improve access to and reduce the cost of energy, many African countries have sought to diversify energy sources as a way of reducing dependence on hydropower. Investments have targeted renewable energy sources such as geothermal, wind and solar. Despite these massive investments, the problems of reliability and cost of energy still persist.

Besides physical inputs, SMEs also require technical inputs in the form of skilled labour and business development services (BDS). Humphrey (2003) argued that even SMEs require highly skilled managerial and technical workers. Similarly, empirical evidence shows that a lack of skilled labour constitutes a constraint to SME upgrading (WEF, 2011). Although the link between worker skills and SME growth has been shown, many small enterprises remain locked in a skills deficiency. On the other hand, highly skilled workers find the SME sector unattractive due to the low wages and limited opportunities for growth. Furthermore, the high rates of failure of SMEs in Africa raise concerns over the security of the employment created.

Regarding BDS, studies show that provision of incubation and training services to SMEs helps to mitigate constraints in markets, finance, technology, and business skills (UNCTAD, 2010). However, there is little evidence of government support to the private sector in the provision of such services. Instead, many of such services are mainly publicly or donor supported raising concerns regarding quality, relevance and sustainability. Moreover, services such as training and credit schemes seem to favour enterprise creation rather than expansion (UNCTAD, 2010). There is also a high level of unawareness among entrepreneurs regarding the existence of these services which are often confined to urban areas. Moreover, lack of coordination among business service providers often leads to rivalry, duplication of efforts and piecemeal interventions.

The effect of BDS on SME growth is well known and there are a number of interventions by African governments, development agencies and private sector in this area. Similarly, it is probable that some enterprises have devised innovative approaches to overcome certain constraints related to skills deficiencies. An understanding of such approaches by the different actors is needed with the possibility of bringing them to scale.

6.4. Policy related constraints

SME growth also depends on the prevailing policy environment. Policies not only create an enabling business environment but also ensure coordination of both public and private interventions aimed at promoting SMEs. However, the policy regime in many developing countries has been characterized by problems of coherence and coordination; limited consultation in the policy process; and bias in favour of foreign enterprises. In Kenya for instance, multiplicity of ministries and departments handling SME issues leads not only to limited focus of strategies but also coordination failure (Ong'olo and Owino, 2013). Similarly, lack of strong sector specific associations at the local level has been associated with limited consultation with the various subsectors during policy making (Ong'olo and Owino, 2013). Consequently, the resultant SME promotion strategies are not only irrelevant but also favour large firms while inhibiting growth among small firms (Fjose et al., 2010). For example, in some cases, investment incentives are either available only to projects above a minimum scale or large scale producers are singled out for special subsidies (Tybout, 2000). Moreover, even when policies do not explicitly favour large firms, these firms may enjoy de facto advantages such as preferential access to credit and protectionist trade regimes due to their ability to lobby the government more effectively (Tybout, 2000).

Concerns are also raised regarding the impact of trade policies on SMEs. For example, market liberalization has exposed SMEs to stiff foreign competition leading to their decimation (Tewari and Goebel, 2002; Tambunan, 2011). In other words, the fast pace of liberalization deters evolution and organic growth of local firms. Similarly, strategies that give SMEs access to public procurement have had only limited impact. Late payment by large clients such as government causes disproportionately serious cash-flow problems to resource-poor SMEs (Aidis, 2005).

7. Summary and Conclusions

7.1 Summary

The paper first discussed the nature of enterprises in Africa and their level of regional and global integration. Although Africa has all types of enterprises carrying out activities in a broad range of sectors, most are small, organised as sole proprietorships. SMEs account for 48.74% of total employment, a proportion slightly larger than the 48.31% attributable to large enterprises. Activities include trade, manufacturing, and services. African countries are increasingly integrated into the world economy and those of their regional neighbours. This integration is marked by increasing market-based trade and financial flows. Although there are efforts to harmonise institutions across the RECs, progress has been slow.

The paper addressed the following four questions concerning SMEs, Trade and Development in Africa:

1. How do African SMEs use clusters and value chains to link with foreign players and external markets?
2. How do support institutions facilitate the internationalisation of African SMEs?
3. What is the contribution of internationalised SMEs to sustainable poverty reduction and employment?
4. What are the main bottlenecks to SME creation, growth, and connectivity to external markets in Africa?

Operating in clusters enables producers to internationalise by helping them to become more efficient, and thus to compete better in global and regional markets, import needed inputs, and create networks with foreign firms. Clustering is especially useful in poor regions seeking to industrialise and which need to mobilise unused resources effectively, as it facilitates specialisation and effective investment in small steps. ICT has become important for SME, but it does not eliminate the benefits of geographic proximity. It promotes facility sharing, easy access to information and product markets as well as training opportunities. Some clusters collaborated more with foreign firms while others developed greater inter-firm linkages among themselves. With regard to support, the private sector proved to be more instrumental while the central or local authorities often provide little support beyond the provision of basic amenities.

SMEs participate in global or regional value chains as producers of finished goods, producers of intermediate goods, traders, and service providers. A frequent development path is for the SME to begin producing for the local market. If there is any internationalisation at this stage, it may involve the purchase of imported inputs, though even here, the most likely way to do this is through importers. Producers who have succeeded in production for the local market may be encouraged to branch out to neighbouring countries and for some, to more distant markets. Although the global value chain literature has suggested that SMEs and even large firms can benefit from the knowledge of global buyers, this is not always the case. To some extent this is due to the attitudes of the buyers towards local SMEs as potential competitors, but may also be the result of the nature of the value chain itself.

Support institutions facilitate the internationalisation of African SMEs in several ways. First, international and national bodies have promoted efforts to improve the general competitiveness of national economies by tracking and encouraging the improvement of a range of institutional indicators. Second, some countries have focused more on specific supports for fostering particular types of exports. Third, some countries are paying particular attention to promoting finance for SMEs with export potential. Finally, the World Bank, has done extensive work on value chains that it has made available to the general public and national governments. A current effort is to do cross-country comparisons of particular value chains in an effort to identify the resource requirements and market prospects.

Increased regional and global integration generally leads to increased trade and FDI. Yet the integration process itself is complex and does not always follow the familiar model of European integration. Each region tends to be different, depending on size of participating countries, presence or absence of a dominant country, geography, and resources available for implementing of agreed activities. Furthermore, the private sector, which is key to the success of integration plans, is often not very involved in the planning process (UNECA 2012).

Internationalised SMEs contribute to sustainable poverty reduction mainly through employment and incomes. Empirical evidence shows that exporting firms contribute more to employment and incomes than non-exporting ones, but many SMEs internationalise at a low level, with only a small part of their incomes derived from international activities. SME internationalisation is constrained by access to finance, business and regulatory environment, trade costs, and access to technology and skills.

More generally, SMEs face bottlenecks hindering their creation, growth, and connectivity to external markets in Africa. These include regulatory and institutional constraints, financial constraints, constraints related to access to non-financial inputs, and policy related constraints.

7.2 Conclusions

Several conclusions can be drawn from the foregoing analysis. The first is that African SMEs seem to be dynamic and have considerable potential for increased internationalisation. Clustering and value chains provide opportunities for linking with foreign actors, thus facilitating firms' internationalisation. Value chains, however, are varied and not all will provide the sustainable incomes that African firms expect from them. It is important, therefore, that studies undertaken use the results of available academic research so that decisions to support certain courses of action are taken with comprehensive and reliable information.

The second conclusion is that SMEs already contribute significantly to employment and thus to sustainable development. If they can grow through internationalisation, they are likely to contribute more. In addition, since many SMEs need services to facilitate their internationalisation, still more jobs are likely to be added through the associations, government agencies, and private sector firms that will grow around the international SME sector. Furthermore, since SMEs are likely to source services from other SMEs, there is considerable potential for the creation of new enterprises as well as the growth of existing ones. Such new enterprises are likely to start small, thus attracting the youth as potential employees. Indeed as Rankin and Roberts (2011) found out, over 2006-2007, about three-quarters of young Africans in South Africa (20-24 years) were employed in firms with less than 50 employees. These firms were considered small in their sample.

Third, boosting African SME participation in trade through trade facilitation and regional integration needs concrete measures such as improved infrastructure, transport, access to finance, and efficient procedures that take advantage of available ICT. Bottlenecks include non-tariff barriers at border points, which discourage entrepreneurs from venturing into external trade on their own. For example, the most important non-tariff barriers hindering regional trade in the East and Southern African region (COMESA, the EAC and SADC) include customs procedures and administrative requirements, technical standards and the lack of physical infrastructure (Hartzenberg, 2011). Manifestations of these include cumbersome documentation requirements, stringent standards, and inefficient road and rail networks which cause time delays and increase the cost of inter-regional trade. Regional bodies need to address this situation to ensure that regional value chains can flourish.

Fourth, the private sector is often left out of key negotiations for global and regional trade agreements. Even when there is some private sector representation, it tends to be by representatives of large well established firms. SMEs should be incorporated into such negotiations so that the resulting agreements reflect their needs. One way to do this is to ensure that business associations make a strong effort to include SMEs as members and that, when they are selecting representatives to participate in trade matters, they have a mechanism for ensuring the inclusion of SMEs.

Finally, if national policies and programmes are to be based on solid evidence, governments need to commit resources to regular trade and industrial data collection by government statistical agencies as well as specific research projects to investigate particular questions and issues.

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