

# THE ENTREPRENEURSHIP CHALLENGE IN AFRICA

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## Abstract

**T**here is a great excitement in SME circles about the political, social, and economic developments taking place worldwide. Of particular interest are developments in emerging countries, especially those of Africa, where it is believed the SME sector can catapult socioeconomic development. But will entrepreneurship and SME develop be the panacea for African economies?

This paper argues that while a positive link exists between economic development and entrepreneurship at least in the developed world (Birch, 1987) one cannot be too sure about a similar research systematically demonstrating the relation in Africa. This raises a fundamental problem.

The problem that emerges when attempting to generalize economic development trends from one economy to another is the lack of consideration of current models of entrepreneurship development. It is widely believed that the development of entrepreneurship is the result of coordination of internal and external components facing the entrepreneur. The favourable nature or lack of it regarding internal and external factors frequently influences the entrepreneurs' ability to create viable organizations. Therefore, external bottlenecks created by African economies need to be removed if SMEs are to be their engines of growth.

## Introduction

In most African countries, especially those south of the Sahara and excluding South Africa, the conditions that existed before the adoption of some measure of economic arrest in the form of International Monetary Fund (IMF) prescriptions were almost moribund. Conditions that existed at that time included:

- Excessive inflation up to three digits.
- Huge budget deficits mainly financed through massive banking sector borrowing.
- Import restriction became draconian as attempts were made to protect a fast diminishing stock of foreign exchange reserves.
- Very low per capital income.

The overvaluation of exchange rates meant contraction of exports, particularly cash crops. Operations in parallel foreign exchange became intensified. There was reduction in the tax base, which placed constraints on revenues of governments. Consequently, in most of these countries, there was an almost "criminal" neglect of infrastructure maintenance. As the economies became stagnant, most employees were forced to adopt survival strategies by means of activities outside of, and frequently in addition to, their formal employment.

## The Role Of Small And Medium Enterprises

The sharp decline of African economies over

the years as a result of both internal and external factors coupled with the poor performance of many large state-owned enterprises (SOEs) of many African countries has brought into sharp focus the importance of SMEs as the engine of economic growth. That it should take an economic decline for countries to realize this basic development paradigm is most unfortunate. Because according to a Netherlands Development Corporation policy document on small-scale enterprise, it has long been known that industrialization is of crucial importance to sustainable development. Only very few countries with a small population and a great wealth of natural resources have succeeded in achieving a high degree of prosperity without industrial development.

In fact, the success of a number of newly industrialized countries, especially in East Asia, has emphasized the importance of the relationship and interaction between agriculture, industry and the service sector. Within each of these sectors, strategic changes are taking place, with employment in agriculture almost always going into sharp decline while employment in services and the industries soaring. Growth in the industrial sector is less rapid than in the service sector, however, mainly because of higher growth in labor productivity in industry during the same period. In any case, the changes referred to highlight the increasing importance of development in the micro and small enterprise sector.

Advantages of SMEs over large enterprises include:

- They make more efficient use of inputs.
- They can be places of learning and training for people at all levels and functions a capacity that could be used in other sectors of the economy.
- They facilitate the creation and use of otherwise non-existence and unused savings.
- They are characterized by dynamism.

flexibility and readiness to innovate, which enable them to adapt more easily to new markets.

- In Africa, they constitute an important source of employment generation and as a means of generating regional industrial and commercial activity thus minimizing the rural-urban drift.

Deakins (1996) attributes the increased importance of the SMEs to their ability to respond quickly to change. As the pace of technological change has increased in society, so the ability of small firms to respond quickly to change has given them an advantage over large firms. This characteristic of SMEs has been called "flexible specialization" and reflects the ability of small firms to be both specialized and responsive to change. Deakins conclude thus "As the demands of society change, it may be that the growth of the small firm merely reflects those demands." (Addaih 2007:44).

#### Definitions of SMEs

The first problem to be overcome in any discourse of SMEs is one of definition. According to Technology Training Center report on SMEs, the Georgia Institute of Technology alone has compiled more than 50 definitions in about 75 developing countries, which could be classified into the following groups:

- Economic sectorial definition
- Commercial financial definition
- Institutional definition
- Statistical definition
- Functional definition
- Technological definition

According to the ILO, SMEs, in the broadest meaning of the term, include modern industrial firms of up to 50 employees, family units of 3 or 4 people, village of cottage industries, associations, companies, cooperatives, owner-operators, mini firms and the self-employed in the non-structured sector of the economy. The term also covers small firms carrying on small-scale, non-manufacturing activities in

construction, transport, maintenance and repairs, trade, etc. (ILO, 1986).

In Ghana, for example, several definitions have been considered at one time or the other. In the industrial statistics published by the Statistical Service, small scale industries are defined as those employing 29 employees or fewer, the rest are all considered medium and large scale. The National Board for Small Scale Industries, on its part, considers a combination of assets as a basis of classification. This apex body charged with the promotion of SMEs in Ghana defines a small-scale enterprise (SSE) as an enterprise which employs not more than 9 workers with an investment in plant and machinery, excluding land and building, not exceeding US\$100,000 (Addaih, 2007).

It can be seen that there is no agreement on the definition of SMEs in Africa. Perhaps, this shows a lack of adequate theory and practice relating to the evolution and role of SMEs on the continent. A report by CSIR for the World Bank suggests that a definition of SMEs as enterprises employing not more than 30 people, including apprentices and permanent employees, as the true reflection of the SME sector given the current size of most African economies.

### **Economic Conditions and Their Effects on SMEs**

Historically, most developing countries have geared their efforts to the single objective of economic growth, concentrating in particular on rapid, large-scale industrialization. Arguably, this strategy could be a necessary condition, but by no means always sufficient in itself, for socio-economic development.

In practice, the preferential treatment of larger firms by government's policy undermined small-scale enterprise. For example, the introduction by means of subsidies of artificially low interest rates for large-scale investments in many African countries distorts the allocation of capital, opens the door to corruption and patronage, and does not increase access for the lower classes.

In addition, subsidized capital often leads to the choice of inappropriate capital-intensive technologies, which does not contribute substantially to the creation of jobs. Fiscal incentives to larger firms, such as tax exemptions, also often have an unfavorable effect on SMEs. In this way, "Many African countries have created a situation in which a minority of the population has ever-increasing amounts of capital at its disposal, while the great majority have to scrape together a meagre existence with very limited resources" (DCI: 15).

Small enterprises are influenced more than others by the environment in which they have to operate. Government policy determines whether there are institutions, which can be of service to them, or, indeed, which will work against them. Paradoxically, however, we observe that policy and regulatory constraints have restrictive effects on the productive potential of SMEs in Africa. First, in many countries, the state has sponsored the development of large-scale firms with policies designed to inhibit direct competition. Second, most states maintain extensive controls over resource allocations, particularly foreign exchange and credit, and often aggravate maintaining fixed or subsidized prices. Large, politically connected enterprises have generally controlled access to financial resources and raw materials. To exist, smaller firms either depend on large firms for access to inputs or pay premium price in parallel markets. Third, tax incentives have been designed for large firms. Fourth, registration procedures are complex and expensive (large firms can spread the fixed cost over larger output, or use their influence to reduce transaction costs). Finally, the hostility of some governments toward private profits and politically powerful business class repress SMEs.

Against this backdrop, the following are some internal economic conditions and their effects on SMEs, and indirectly their effects on enterprise development. It must be noted that some of the conditions are causally interrelated as outline on the next page:

- **High inflation rates:** Little productive investment, particularly in small industries. Investments in gold, real estate, cattle, more wives and children, offshore foreign currency accounts are likely to be more common.
- **Declining per capita income:** Less demand for products and services of SMEs.
- **Low wages in the public sector:** Outflow of skilled personnel; personnel to implement SME programs have to find other sources of income. The lack of incentives brings about program administration problems. Development policies, if formulated become difficult to implement.
- **Exchange rate and shortage of foreign exchange:** Exchange rates have been a major disincentive for local production. Shortages of spares, raw material and capital equipment. Large industries and enterprises gain priority in accessing foreign exchange.
- **Price controls:** SMEs producing consumer items frequently are squeezed by high priced and low selling prices.
- **Trade liberalization:** Often makes some imported and smuggled goods cheaper than local products of SMEs.
- **Low tax revenues:** Fewer or no development program services for SMEs. Attempts to broaden the tax net could bring about increase in government activity to extract more taxes from the SME sector, and reinforcement of the usual apprehension of small enterprises of government officials.
- **Deterioration of infrastructure:** Everyone, particularly those in remote areas have to pay more for SME inputs, or marketing.

- **Poor credit facilities and negative interest rates on savings:** Few incentives for SMEs to open bank accounts and to enter into formal credit system. SMEs have little access to resulting scarce loan funds and forced to depend on black-market credit sources or family savings.

### **Constraints of SME Development**

Several problems confront the small and medium scale business operators. These problems include managerial capacity, technical know-how, technology, capital, marketing problems, and miscellaneous production bottlenecks. Similarly, Baa-Nuako and others, in a recent study of the "Growth and Transformation of Small Firms in Africa" identified six major sources to have constrained the growth of SMEs in Ghana as follows:

- Entrepreneurial attitudes.
- Firm characteristics and operations.
- Equipment acquisition and technological advancement.
- Sales and product support and market orientation.
- Business support and perception.
- Formality and management capability.

### **Private Sector Development**

To achieve rapid self-sustained growth, African countries must overcome several major obstacles to private sector development in attempt to ensuring that SMEs champion the sector as the engine for growth of their economies. The general lack of confidence in the business environment among private sector SMEs have been frequently noted. The confidence issue is partly a legacy of past policies. Serious economic mismanagement prior to the adjustment program had led to chaos and real hardship both of which remain vivid in the collective memory. Even during the period of recovery, the economic climate was clouded by official actions that posed serious threat to private business. Properties were seized and people's lifetime savings were confiscated. Prosecutions of individuals were actively pursued under normal and paralegal

channels. Business opportunities were constrained by the presence of public enterprises with powerful political connections.

**Availability of Credit:** The absence of confidence shows up in the banking system. Deposits at the banks represent only about 8 percent of GDP in recent years. This failure to mobilize resources is in turn restricting the access to credit thereby raising the cost of funds, with pervasive repercussions in the economy. For example, Ghanaian business owners consider the difficult access to credit as one of the most serious problems facing SME operators.

**Labor Markets:** Wage rates and quality of labor represent a major part of business decisions, particularly those of foreign companies. Wage rates in the country remain competitive by international standards, but the relatively low level of education and skills of the average worker offset this wage advantage. Furthermore, the poor quality of infrastructure and support services in Ghana tends to erode the country's competitive position.

**Commercial Assets:** Public sector ownership of commercial properties is also pervasive. Local authorities and public enterprises control substantial amounts of commercial property and land. Whilst agreeing that government ownership of land and commercial structures needs further research, Leechor nevertheless postulates that the supply of commercial properties is substantially more restricted than it would be without such extensive ownership. Additionally, entrepreneurs operating in rented premises have little incentive to make extensive investments to upgrade and develop the properties.

**Addressing The Presence Of Public Enterprises:** To a private entrepreneur, public enterprises pose a significant threat. To overcome some of their disadvantages, many entrepreneurs evade taxes. Even if successful, the benefits of tax evasion offset only a small part of the disadvantages. Clearly, private entrepreneurs have to seek out the activities

and niches in which public enterprises have not already occupied. But which niche remains unoccupied? In the presence of such competition, investment is the preserve of those with exceptional business acumen or those not too sensitive to risks. Ordinary law-abiding and risk-averse entrepreneurs probably would not invest in this environment.

**Restricting Monopoly Power:** Many legal barriers have been erected to restrict the entry of private companies. The most visible restriction, according to Husain and Faruquee, applies to cocoa trading in the case of Ghana. Until 1992 private companies were not allowed to trade cocoa in competition with the state-owned Cocoa Marketing Board. Since 1992 private companies have been granted the right to buy and sell cocoa within Ghana but the Board still exclusively undertakes exporting.

In Ghana's energy sector, a few state-owned entities monopolize production, pricing, and marketing. These entities are the Ghana National Petroleum Company (GNPC), Volta River Authority (VRA), and Electricity Corporation of Ghana (ECG). Numerous restrictions apply to other industries. In the insurance business, for instance, policies covering a public sector organization or its purchases can be written only by the state-owned State Insurance Company. This restriction allows SIC capturing about 80 percent of share of the public sector insurance market. Similarly, in the pension fund business, a mandatory contribution of 17.5 percent of each company's wage bill goes to the government-owned SSNIT, which is the only pension fund in the country.

Efficient and competitive private sector firms not develop solely because of their own internal capabilities. While innovative entrepreneurs, skilled managers, a dedicated and well-trained workforce, and efficient administrative and operational procedures are important, the number, size, and efficiency of enterprises in a country are affected by a host of external factors.

Generally, the private sector needs an overall enabling environment, which allows firms to operate efficiently and specific institutions and policies that promote private sector develop. Most of these factors which were discerned at a National Economic Dialogue held at the beginning of the century in Accra in 2000 include:

- **Microeconomic stability:** A key to economic growth is prudent economic management that avoids volatility and uncertainty. Policies that lead to high inflation, excessive taxation, distorted factor prices, or lack of foreign exchange frequently discourage business formation and investment.
- **Financial system:** An efficient financial system is an important pre-requisite for economic development in mobilizing savings and channeling them into investments. For private sector firms, it serves an additional purpose besides providing them credit. It is also a means of enforcing discipline on firms that borrow.
- **Competitive markets.** Even more important to economic development and private ownership is the presence of competitive markets. Competition promotes efficiency. Policies that promote intensive and fair competition will result in competitive enterprises and a strong private sector.
- **Access to markets:** Building and enhancing our competitiveness to access internal and external markets.
- **Regulation:** Regulation of the private sector is necessary to ensure competition and fair trade, but unnecessary regulation burdens the private sector and leads to fewer and less efficient enterprises and reduced competition.
- **Physical infrastructure:** The size, characteristics, and efficiency of the

private sector depend very much on the available infrastructure. Public investment infrastructure "crowds in" private investment.

- **Political and social stability:** To operate efficiently, the private sector requires a generally conducive political and social environment. Institutions such as public administration systems, security, schools, and hospitals are necessary for the stable society that provides an environment for sound economic development.
- **Legal framework:** Business, like society in general, needs to operate under the rule of law. No strong private sector can exist in the absence of an adequate legal framework to resolve disputes, facilitate efficient transactions, and protect property rights.
- **Policy frameworks:** Various policies, even those not directly related to the private sector, can affect its growth and size. Policies that provide adequate support to the private sector are essential.
- **Access to resources and support services:** Entrepreneurs and owner-managers need access to finance, information, and various types of support services to create and operate business in the most efficient and competitive fashions.

### Conclusion

A comprehensive policy framework governing the operations of the private sector should be formulated and implemented to facilitate the sector's development. Such a policy framework needs to be consistent with the overall macroeconomic conditions of the nation. It should include a range of policies, procedures, and laws that provide both the regulation and the promotion of SMEs. Such a framework should essentially be harmonized with specific policies for industry, investment, energy, and entrepreneurship development.

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