



Chapter 8

Policies to promote entrepreneurship for Africa's industrialisation

This chapter identifies the most binding constraints that African entrepreneurs face and focuses on three important policy areas to help entrepreneurs contribute to industrialisation. To strengthen Africa's firms, governments should develop entrepreneurs' skills, improve infrastructure, notably for business clusters, and facilitate financing. First, this chapter discusses how to promote education and professional training for entrepreneurs and wage workers. Second, it examines how clusters can kick-start industrialisation by providing enabling conditions for African firms to grow. Third, it explores ways to finance small and medium-sized enterprises, including high-potential firms. It also proposes ways for governments to co-operate with the private sector in designing and implementing the necessary policies.

EXECUTIVE SUMMARY

A holistic policy approach is needed to strengthen entrepreneurship for Africa's industrialisation and tackle the multitude of constraints. This chapter focuses on three policy areas of particular importance. The first is improving skills of entrepreneurs and of workers in general and aligning them with labour market needs. While governments can promote learning, engaging the private sector is necessary. The second policy area relates to grouping firms in business clusters, such as industrial parks and special economic zones. Clustering can support start-ups and increase existing firms' productivity and growth, assuming adequate infrastructure is available. The third important policy area is improving firms' access to funds. Financial markets should be able to grant affordable loans and provide more diverse and innovative financing instruments to Africa's firms, including its small and medium-sized enterprises.

Did you know?

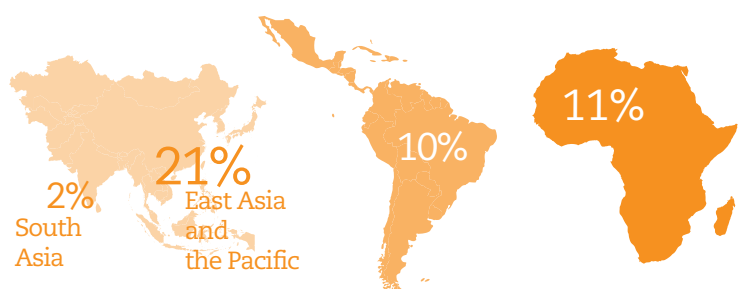
- Credit providers will need to increase their lending by at least USD 135 billion in order to meet demand by African MSMEs.
- Each US dollar that multilateral institutions invest in African entrepreneurs can generate up to USD 5 in additional private sector investment.
- African firms are 19% less likely to obtain a bank loan than firms in other developing regions.
- In Uganda, 28% of women own land compared to 53% of men, and only 10% can use it as collateral compared to 95% of the men.

Improving Africa's entrepreneurship for its industrialisation



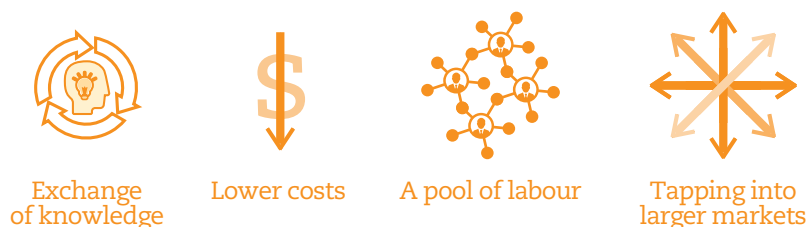
Improving skills

Share of students in secondary education enrolled in vocational programmes:



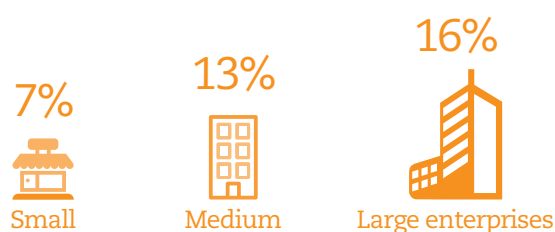
Grouping business clusters

Benefits:



Improving access to funds

Proportion of working capital financed by banks in Africa:

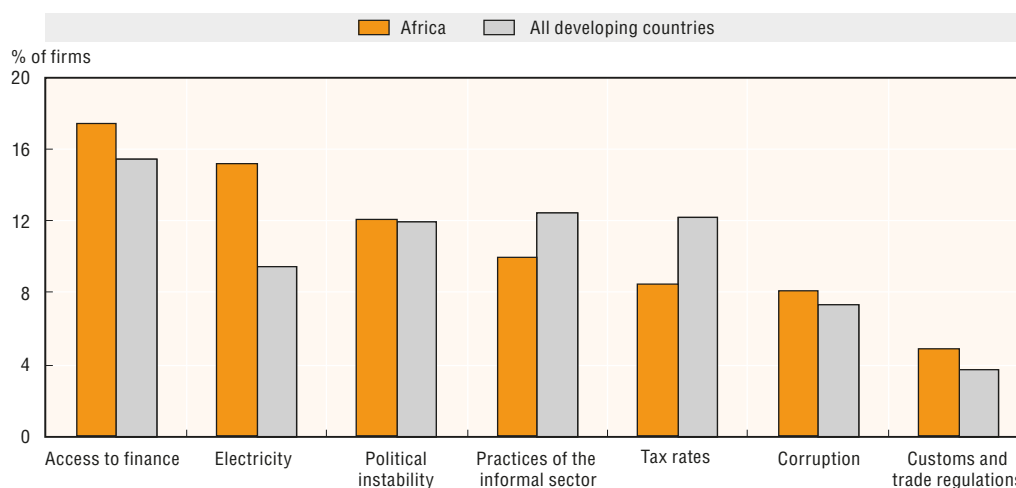


Policies that facilitate business for entrepreneurs are crucial for Africa's industrialisation

For Africa to industrialise, its entrepreneurs need government policies that help their firms grow. Identifying binding constraints to growth is a key step before designing policies (Lin and Monga, 2013). The constraints that entrepreneurs face when starting firms or upgrading their operations relate particularly to skills, infrastructure and the business environment, and financing. Upgrading skills is particularly important to better use the opportunities of new technologies for industrialisation. African firms' cite infrastructure, notably an unreliable electricity supply, and access to finance as their most common operating constraints (Figure 8.1).

Numerous policy areas can impact enterprise performance and their contributions to industrialisation. These include improving general economic conditions through sound fiscal and monetary policies and appropriate exchange rates, boosting the business environment, enforcing stable regulatory frameworks and ensuring fair trade relations. Reducing trade barriers will increase the size of markets that African entrepreneurs can tap (see Chapter 3). However, implementing such policies at the macroeconomic level alone is not sufficient. Policies need to be tailored to the specific conditions, needs and capabilities of individual countries (see also Bhorat et al., 2016). In that way, they can nurture entrepreneurship, firm survival and growth, which are critical ingredients for rapid and sustained industrialisation (see Chapters 6 and 7).

Figure 8.1. African firms' most common operating constraints, 2015 or most recent year



Source: Adapted from Enterprise Surveys, www.enterprisesurveys.org.
StatLink <http://dx.doi.org/10.1787/888933475494>

Entrepreneurs need better infrastructure and a more supportive business environment

Infrastructure gaps reduce the growth potential of entrepreneurs, and electricity in particular stands out as a major problem (Omidyar Network/Monitor Group, 2013). Infrastructure is a key component in promoting industrialisation, raising incomes, accumulating human capital and facilitating access to markets (Lin, 2012). High-tech entrepreneurs, for example, suffer from unreliable electricity supplies and are often too small to afford efficient generators for themselves.

Weak physical and soft logistical infrastructure limits the catchment area of new entrants to their immediate surroundings. For example, entrepreneurs in the agro-food

sector face difficulties in bringing produce from rural areas to processors and consumers in urban markets due to the nascent development of cold chain logistics.

Young firms face more difficulties in an unfavourable business environment than more experienced firms. Young firms can be too small to negotiate better terms with the government yet too visible to avoid a disproportionate share of taxes and cumbersome bureaucracy. They therefore often remain in the informal sector to avoid burdensome regulations for formal enterprises. But informality restricts their productivity (Box 8.1). Weak property rights and weak contract enforcement mechanisms reduce the return on otherwise successful ventures and discourage entrepreneurs from innovating. A non-transparent regulatory environment in labour market rules, taxation, red tape procedures, property rights and bankruptcy laws are particularly harmful to firms' growth in developing countries (Quatraro and Vivarelli, 2014).

Removing these constraints would significantly boost firms' productivity and allow African entrepreneurs to compete with other global players (Harrison, Lin and Xu, 2012; Dinh and Clarke, 2012). After accounting for their more challenging environment, Africa's manufacturing firms tend to perform better than those in other regions of the world at similar income levels (Dinh and Clarke, 2012).

Box 8.1. Policies to upgrade firms from the informal to the formal sector

Informal firms represent over half of Africa's economic activity (La Porta and Schleifer, 2011). Micro, small and medium-sized firms and sometimes even larger firms operate in the informal sector. Informal firms tend to produce less than formal ones, due in part to lower levels of skills, a smaller size, which prevents exploiting scale economies, and a restricted use of government services and bank financing. Hence, bringing more firms into the formal sector could increase productivity and promote growth.

Policy makers should consider the reasons why various types of firms operate in the informal sector and should assess their ability to upgrade to the formal sector. Simply forcing informal firms to register and comply with the rules for formal firms could be counterproductive, reducing employment and increasing poverty (Jütting and de Laiglesia, 2009). Better policies to cope with informal firms include the following:

- help micro firms increase productivity and income via microfinance programmes and education
- validate skills acquired in the informal sector through certification (see the examples of Benin, Ethiopia, Mali, Senegal and South Africa in AfDB/OECD, 2008)
- improve access to finance, property rights, regulations on bankruptcy, energy market reforms and infrastructure.

Credit constraints prevent firms from growing

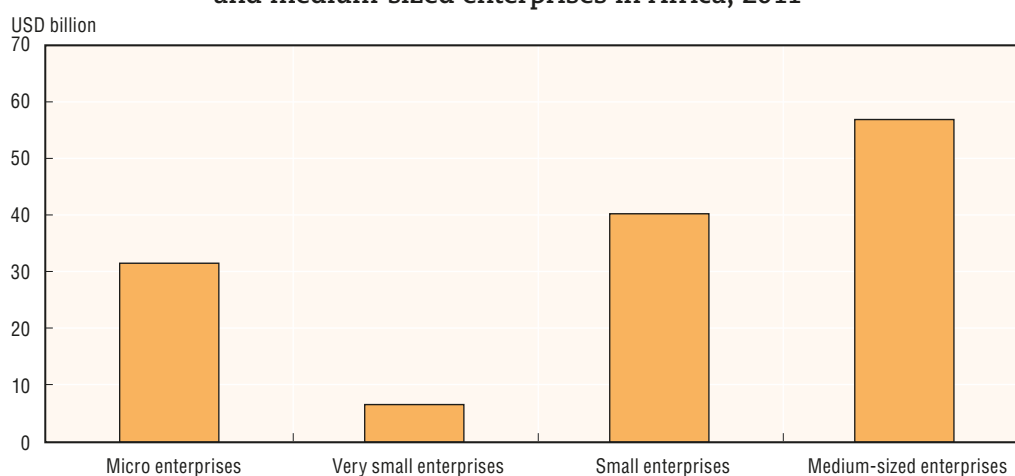
Africa's micro, small and medium-sized enterprises (MSMEs) in the formal sector lack financing. They face a credit gap on the order of USD 136 billion (Figure 8.2).¹ The reasons are fivefold:

1. Most entrepreneurs rely on personal savings and their immediate personal network for start-up capital (Beck et al., 2011). Bank lending and venture capital play a limited role in financing entrepreneurs, at least in the start-up stage.
2. For women, gender-based legal restrictions may prevent them from owning property, making it harder to obtain loans (Dupas and Robinson, 2013; Box 8.2).
3. Entrepreneurs often believe supply of capital is limited, while financiers claim that entrepreneurial projects are not fundable (Omidyar Network/Monitor Group, 2013).

4. Mid-range financing for entrepreneurs is limited. Government programmes and non-profit institutions provide primarily small scale, micro-lending schemes, and the formal banking system offers large-scale funding.
5. Long-term borrowing and equity financing is rare. Almost 60% of loans in Africa are for less than one year, and less than 2% of loans are for more than ten years (Beck et al., 2011).


Financial literacy and business training can help African entrepreneurs present their business cases to lenders. Financial education can include identifying ways to fund start-ups using existing resources or external finance (OECD, 2015a).

Figure 8.2. Total credit gap for formal micro, very small, small and medium-sized enterprises in Africa, 2011



Note: Formal micro, small and medium-sized enterprises are classified into 4 groups: micro (1-4 employees), very small (5-9 employees), small (10-49 employees) and medium (50-250 employees).

Source: Adapted from IFC's Enterprise Finance Gap (2014).

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The consequences of constraints to private sector development often fall disproportionately on new entrepreneurs. Start-ups are more subject to credit constraints and are less resilient. In OECD countries, policies that aim to lower risks, e.g. improving access to finance, tend to improve the entry and growth performance of start-ups. It is also crucial to tackle policy failures that increase the costs of risks, e.g. poor contract enforcement (Calvino, Criscuolo and Menon, 2016).

Box 8.2. African women and entrepreneurship

Helping women entrepreneurs develop viable and productive firms requires an integrated strategy. Many African countries need to improve women's rights to make decisions about their own lives and enterprises with adequate, flexible and affordable financial services and business education. Many women entrepreneurs find financial services inaccessible due to high interest-rates and inflexible repayment schemes. They have difficulty complying with collateral requirements for credit and loans due to gender biases in land ownership (Vossenbergh, 2016).

Women entrepreneurs face additional constraints which affect their firms more than those of men. Often women endure harassment and discrimination in the market place and from government and financial institutions. In Uganda, 28% of women own land compared to 53% of men; but only 10% of female landowners can use land as collateral compared to 95% of male

Box 8.2. African women and entrepreneurship (cont.)

landowners (OECD, 2015b). Furthermore, women experience inequalities in intra-household decision making and bargaining over how financial resources are allocated and tasks divided. Social pressure related to what is considered appropriate behaviour for women has an impact on their entrepreneurship. Also the types of tasks and duties that some African societies expect women, rather than men, to perform limit their access to and control over resources for running a profitable business.

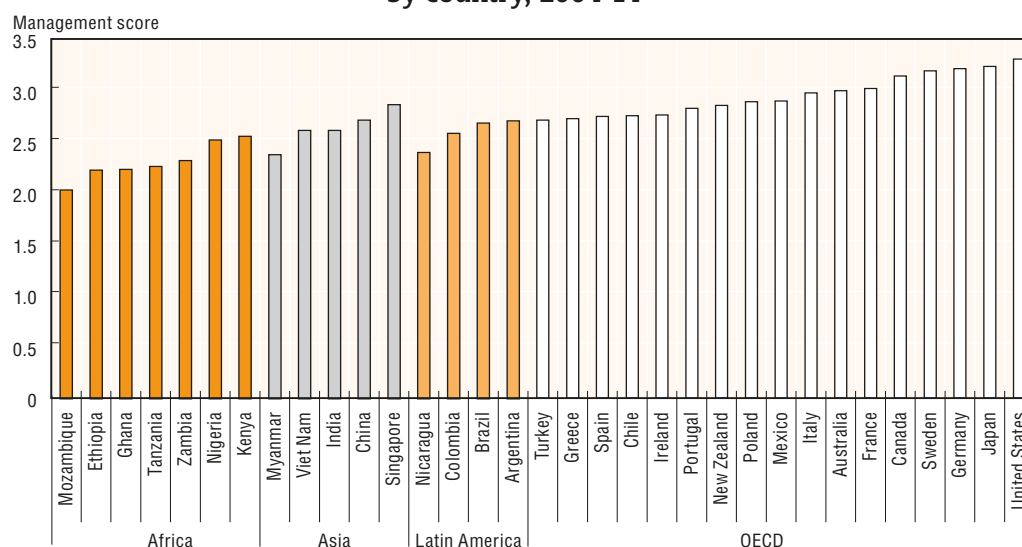
Governments, companies, financial institutions and other key actors in the business environment should respect women's rights to access and control resources. Africa's Grow Movement is a successful example of an organisation that offers innovative, inclusive and empowering business education services to women entrepreneurs (Vossenbergh, 2016).

A lack of managerial skills inhibits growth

A lack of managerial skills is one of the main constraints to successful entrepreneurship in Africa. Together with inadequate worker skills, it hampers Africa's productivity and competitiveness and holds back industrialisation (AfDB, 2016; AfDB/OECD/UNDP, 2014). The quality of management in African countries trails behind that in other developing countries (Figure 8.3). A survey of medium-sized manufacturing firms in 34 countries shows that the 7 African countries included in the sample are at the bottom of the management quality ranking. A similar review of light manufacturing shows that a lack of basic managerial skills is one of the four main impediments to the industry in Africa (Dinh et al., 2012).

Research points to insufficient managerial skills and experience as a key factor in the failure of new business ventures (Martin and Staines, 1994). South Africa is a case in point. Herrington and Kew (2016) linked the country's low levels of entrepreneurial activity and management capabilities with ineffective entrepreneurial education and inadequate mathematics and science teaching at primary and secondary school levels. This may also explain the high failure rate of new firms in South Africa.

Figure 8.3. Average management scores of medium-sized manufacturing firms by country, 2004-14

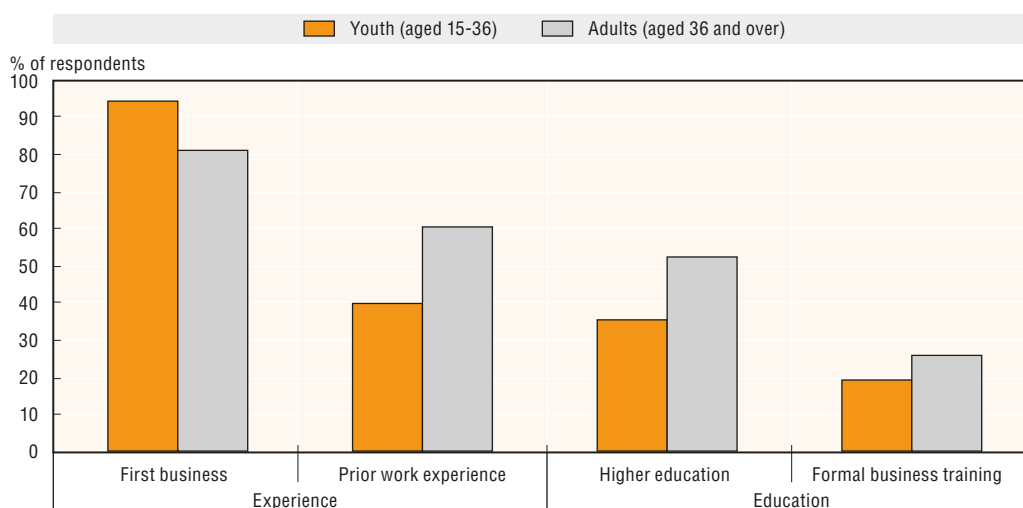


Source: Bloom et al. (2016).

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A lack of skills is particularly relevant for African youth. The shortage of entrepreneurial skills lowers the ability of potential young entrepreneurs to find business opportunities and reduces the rate of youth start-ups. For instance, the 2013 UN Swaziland survey of 640 small and medium-sized enterprises (SMEs) in six Swaziland cities revealed a large gap in experience and skills between young entrepreneurs (aged 15-35) and adult entrepreneurs (aged 36 and over) (Figure 8.4). Only 40% of young entrepreneurs had prior work experience, relative to 61% of adults. While a third of young entrepreneurs had higher education, more than half of the adults did. Similarly, less than 20% of young entrepreneurs received formal business training, and over 25% of adults were trained.

Figure 8.4. Experience and education of young versus adult entrepreneurs in Swaziland, 2012



Source: Adapted from Table 1 in Brixiová, Ncube and Bicaba (2015).
StatLink <http://dx.doi.org/10.1787/888933475528>

Policies to tackle these issues will have to be holistic and context-dependent. Since Africa's constraints are interdependent, lifting them in one dimension while others are still binding may prove ineffective. The following sections will examine policies to improve skills, business clusters and financing to strengthen the existing entrepreneurial base for Africa's industrialisation.

Improving skills is essential to strengthen Africa's entrepreneurial capacity

Prioritising education systems can prepare entrepreneurs for the new industrial revolution

Africa will have to prioritise education and massively upscale its investments in the quality of its workforce in order to partake in the new industrial revolution (see Chapter 6). Education outcomes and systems in Africa currently perform poorly compared to global averages. Improved school systems are necessary to equip entrepreneurs and workers with the skills needed to boost the competitiveness of firms and modernise the economy (Shimeles, 2016). Research shows that the mind-sets and skills closely tied to entrepreneurship are transmittable when education and training systems incorporate creative and entrepreneurial skills into teaching (Banerji et al., 2010).

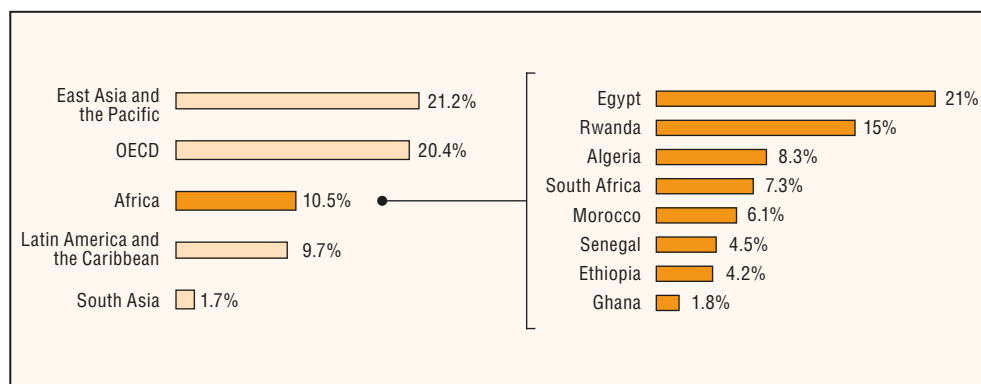
Formal education in Africa could better integrate entrepreneurship training. Entrepreneurship education is still rare. Making entrepreneurial education available to the majority of students will require great efforts from all stakeholders (Lackéus, 2015).

Some countries have already integrated entrepreneurship into their education systems. With youth making up more than 75% of its population, Uganda has remodelled its education system which now includes entrepreneurship as one of the subjects of instruction in secondary schools and colleges.² In partnership with universities of six African countries, the E4Impact Foundation has trained some 600 entrepreneurs. It offers courses on creating bankable business plans, developing managerial skills, and establishing business networks with potential partners and investors.


Policies to develop skills should build on the local context. An assessment of a national entrepreneurship education programme in South Africa shows that the programme's implementation suffered when not taking local conditions into account (Isaacs et al., 2007). Continuous evaluation of education and training programmes is essential.

While vocational training can contribute to productivity gains, it is currently an underutilised tool. World Bank data show that the average rate of vocational training enrolment by secondary school students in Africa is only 10% (Figure 8.5). Such low enrolment signals insufficient public training capacity relative to the continent's population growth.

Figure 8.5. Share of students in secondary school enrolled in vocational programmes, 2013 or most recent year



Source: Adapted from World Bank (2017).

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Despite the importance given to skills development by many governments, the training system in Africa is largely underfinanced. On average, only 2-6% of educational budgets are devoted to skills development. In many countries, funding is mainly channelled towards formal technical and vocational training (AfDB/OECD, 2008).

Training programmes and apprenticeships help provide the necessary skills

African countries need more institutions and programmes that can actively bridge the gap between industry needs and education, notably by focusing on management and problem-solving skills. Business schools and colleges for technical and vocational skills development (TVSD) could develop stronger links to the commercial sector and focus on apprenticeships, management support and lifelong learning for entrepreneurs of small firms. TVSD refers to the acquisition of knowledge, practical competencies, know-how and attitudes necessary to perform a certain trade or occupation in the labour market. TVSD encompasses formal learning – in public and private educational institutions or on the job – and non-formal learning within or outside the work place, “aiming to ensure that all members of the community have access to lifelong learning. TVSD includes both initial vocational training undertaken by young people prior to entering the labour market and continuing vocational training for adults” (AfDB/OECD, 2008).

Given the multitude of constraints affecting entrepreneurs, a combination of skills development, provision of capital and business mentoring may be most effective to help them (Honorati and Cho, 2013). The increased automation in industry brought about by the new industrial revolution will require entrepreneurs and wage workers to focus on developing skills that can allow them to complement the role of machines (see Chapter 6). Today's entrepreneurs and wage workers need a broader coverage of social and creative skills geared towards solving concrete problems (Naudé, forthcoming). Specific skills that deserve attention include management, leadership, marketing and sales, and communications.

Informal apprenticeships can build skills for those with no education or formal job prospects. The majority of young people in Africa lack the general qualifications to enrol in TVSD programmes, since these require at least some secondary schooling (Filmer et al., 2014). As a result, informal apprenticeships are widespread in Africa, particularly in West Africa (i.e. Benin, Côte d'Ivoire and Ghana). They represent the principal means of acquiring skills in urban areas. In Ghana, informal apprenticeships represent up to 90% of basic skills training (Atchoarena and Delluc, 2001). Almost 25% of the working population are apprentices (Palmer, 2009).

The choice between formal TVSD and informal apprenticeships often determines the labour market outcome of individuals (Filmer et al., 2014). Apprentices tend to become self-employed, while TVSD graduates opt for wage employment. In Ghana, apprenticeships have allowed self-employed individuals to earn 49% more than wage workers.

Applied training can help established small firms expand their business, particularly when they are located in clusters. A randomised experiment in Ghana's Suame Magazine cluster found initial managerial skills to be poor. In the period that followed, some entrepreneurs were randomly selected to receive basic managerial training, which included bookkeeping, marketing and production management. Entrepreneurs in manufacturing activities who received the training benefited from higher gross profits compared to those who did not receive any training and whose managerial skills remained low (Iddrissu, Mano and Sonobe, 2012). In a Tanzanian cluster, on-site training on management practices led to increased productivity, value added and gross profits (Sonobe, Suzuki and Otsuka, 2011).

At the same time, apprenticeships can carry risks, such as limited skill transfers or prolonged and underpaid employment. In order to counter such risks, the International Labour Organization proposes formalising and standardising apprenticeships as well as training craftsmen following a "train the trainer" approach. Several African countries where apprenticeships contribute to the national skills base are already implementing such policies (ILO, 2011). Many African countries "have enacted formal apprenticeship laws. [These laws regulate] among others, official registration of contracts; access to apprenticeships such as educational or age requirements; training duration; and skills assessment and certification procedures" (AfDB/OECD, 2008). However, only a small number of mostly medium-sized and large enterprises have been able to apply these rules. Therefore, only a small share of young people in Africa have benefited from formal apprenticeship.

Private sector engagement is a centrepiece of skills development policies

Strengthening the dialogue with the private sector can increase the relevance of training (see also Chapter 7). Partnerships with enterprises, business, industry, craft associations, unions, and other formal and informal stakeholders can make training more relevant to the labour market. The private sector can contribute to the design and delivery of training programmes, particularly through offering internships, providing on-the-job training, financing training institutions and giving advice on curriculum reforms



(Bughin et al., 2016; Naudé, forthcoming). Increasing the role of the private sector can help develop more demand-driven training systems. In particular, private companies tend to provide more training in “the tertiary sector of the economy, e.g. business, commerce and information and communication technologies” (AfDB/OECD, 2008). Trade associations can help certify informal apprenticeships by defining the content of necessary skills and competencies.

Training by the private sector correlates positively with programme success (Honorati and Cho, 2013). In Morocco’s Tangier automotive cluster, the government established two training facilities and subsidised 20% of the cost of training courses provided by the private sector. These courses mainly target factory workers and aim to enhance skills on the factory floor. Local universities created partnerships to train technicians and engineers, while one of the cluster’s training centres also provides management courses (Benabdejlil, Lung and Piveteau, 2016). More generally, Morocco’s *Plan Emergence* (2008-15) launched eight sector-specific training centres built by the state but run by industry associations. While some programmes are privately funded and managed but also receive public funds, others are entirely run by the private sector. One such example is the Office Chérifien des Phosphates (OCP) Group’s sectoral competency centres, which are located in OCP production regions and provide general skills as well as more specialised training linked to OCP activities.

Local manufacturing firms and African governments can engage with foreign enterprises or institutions in technical assistance partnerships (Dinh et al., 2012). These partnerships can develop the technical skills of the local workforce, ultimately raising firms’ productivity. Beyond Africa, Chile’s Framework for Mining Qualifications provides an example of involvement of the private sector. Guided by private sector demand, this initiative informs training institutions of which skills should be offered and advises workers on the skills they should build (OECD/CAF/ECLAC, 2015). Box 8.3 gives an African example.

Box 8.3. AfDB Skills Enhancement Zones

The AfDB launched a Skills Enhancement Zones (SEZs) programme in 2016. It aims to develop young entrepreneurs and enhance the skills of youth to meet private sector needs, as part of its Jobs for Youth in Africa Strategy. Rather than the traditional two to three years approach used in vocational schools, the SEZ programme promotes a faster response to economic opportunities through six-month training. It targets specific, on-demand skillsets. Established in industrial parks, SEZ training centres give trainees direct access to on-the-job training. The programme involves employers across several countries to strengthen industrial collaboration at the regional level.

Policies need to better incentivise training by private companies. Often, firms do not recognise the value of employee training. They tend to lack awareness of how training can increase productivity or fear that other firms poach trained workers. Policies to address these concerns include sharing the costs of training with private companies; offering tax reductions to participating firms; better representing specific industries’ interests in training; and communicating the benefits of TVSD programmes more widely to private actors (AfDB/OECD, 2008).

The local level context can be decisive in determining policy outcomes. For this reason, involving sub-national governments in policy design, implementation and evaluation is advisable. Decentralising the management of TVSD can enable training centres to diversify their sources of finance, improve the partnership between enterprises and

training institutions, and offer training that better responds to local demand and promotes local assets. For instance, Tunisia's decentralisation of vocational education and training institutions has led to improved partnership between training institutions and private companies, although private sector participation remains uneven (AfDB/OECD, 2008). However, the responsibilities of sub-national governments and local training centres must depend on their administrative, managerial and pedagogical capacity as well as on transparency requirements (Chapter 7). Measuring and rewarding schools' educational and financial performance can help address transparency and capacity challenges, as shown in Mozambique.

Increasing the funding to scale up TVSDs will be necessary. Possible measures have been discussed in the AEO 2008. These include increasing government budget allocations for TVSDs; improving training centres' capacity to manage their budgets; introducing equitable cost sharing schemes targeting specific groups of trainees or students; promoting private training providers; and working with donors' agencies that promote skills development.

In formulating policies, priority actions differ according to the skill level in a country and the proportion of survival entrepreneurs, i.e. those who are pushed into entrepreneurship when other options for work are not available (see Chapter 6).

1. Countries with lower skills profiles and a higher proportion of survival entrepreneurs could
 - encourage survival entrepreneurs to shift to wage employment by providing on-the-job or applied training programmes, notably in priority sectors with lower educational requirements. Skills development for poor people can be integrated into poverty reduction programmes. Community involvement can help illiterate poor people upgrade their skills and participate in more sustainable economic activities. Pre-vocational training for children who have left school but are not old enough to start an apprenticeship could strengthen their academic credentials while introducing them to a potential occupation (AfDB/OECD, 2008).
 - identify opportunity-driven entrepreneurs and target short, demand-driven training that will enable them to develop their firms. Such training needs to be complemented with experienced mentoring, post-training support and finance mechanisms to accompany those entrepreneurs. On a longer policy horizon, more opportunity-driven entrepreneurs will need better access to business schools and technical vocational colleges with a strong link to the commercial sector and lifelong learning.
2. Countries with higher skills profiles and a smaller population of survival entrepreneurs could
 - promote on-the-job learning, notably through formalisation and recognition of training in the informal sector. Certificates, for example, could officially recognise training and qualifications. Experienced mentoring should complement on-the-job learning. Educational facilities and infrastructure for education could be further improved, notably in targeted business clusters. Enhanced co-operation with foreign companies could also promote the transfer of specialised skills to local workers.
 - develop complementary long-term solutions such as introducing entrepreneurial education into school and university curricula and creating national and regional centres of excellence. Such centres would help harmonise training programmes and provide platforms for scientific and technological research and exchanges with non-African institutions.



Business clusters can help African firms grow

Business clusters in Africa can help overcome growth constraints that are still common for many firms (McCormick, 1999), thus acting as catalysts for industrialisation. Clusters enable resource-constrained governments to prioritise and address multiple constraints holistically. For budget-constrained countries, clusters can help focus resources in “pockets” of infrastructure. Such areas can foster industrialisation more quickly, providing an environment that enhances firm survival. Clusters enable interaction and linkages between companies, suppliers, service providers and associated institutions (UNECA/AU, 2014).

Business clusters are long recognised as a means to industrialise. In 1890, Alfred Marshall argued that for certain industries, smaller firms grouped in the same location could achieve productive efficiency. Rather than in large, vertically integrated firms, production can take place through “external economies”, i.e. the specialisation of labour and firms in specific tasks and the existence of highly specialised suppliers. More recently, clusters have been defined as “a geographically proximate group of interconnected companies and associated institutions in a particular field, linked by commonalities and complementarities” (Porter, 1998).

Clustering offers four broad benefits. First, the proximity of firms enables the transfer of knowledge, ideas and technology, which can lead to innovation and growth (AfDB/OECD/UNDP, 2016). Second, clustering allows firms to benefit from common infrastructure and shared services, lowering overhead costs. Third, it creates a pool of labour, raw materials, suppliers, etc. which allows firms to focus on tasks in which they hold a comparative advantage. Fourth, clustering enables firms to tap into large markets (Zeng et al., 2008; Otsuka and Sonobe, 2011).

Clustering can help firms achieve greater productivity and efficiency. In Ethiopia, manufacturing firms located in clusters tend to become more productive when competitors enter the cluster. Total factor productivity increases by 0.92% for every additional competitor firm in the cluster (Siba et al., 2012), though the effect relates strictly to the entrance of firms producing the same products. On efficiency gains, a firm-level survey in three Tanzanian cities (Arusha, Dar es Salaam and Mbeya) and one in Uganda (Kampala) found that a 10% increase in the number of firms within the same sector reduces firm costs by 0.3-0.4% (Imi, Humphrey and Melibaeva, 2015).

Urban areas are conducive to clusters because of the higher density of people, ideas, infrastructure and services (AfDB/OECD/UNDP, 2016). Cities in countries at all levels of development host a higher proportion of manufacturing and service firms (Newman et al., 2016). A study of South African SMEs in the clothing industry shows the importance of cities as marketplaces. By clustering in urban areas, firms benefit from information sharing, production linkages and access to a larger customer base (Rogerson, 2000).

Clusters can provide fertile ground for foreign direct investment (FDI) thanks to economies of scale. Clusters can attract FDI inflows by increasing returns to investment (Yehoue, 2009). Yehoue states that “a dense network of domestic firms can compensate for policy-induced distortions” and factor misallocation, thus attracting foreign investment. Ketels and Memedovic (2008) also argue that clusters can enhance the attractiveness of a country as an FDI destination.

Industrial parks and special economic zones are clusters established by the state for industrial development. Their purpose is to attract businesses in delimited areas by providing public goods and preferential regulations. Both types of clusters are widespread in Africa. These zones can serve as testing grounds for public policy, given their delimited administrative borders. The relatively higher density of firms can lead to higher spillovers and knowledge transfers, which in turn can increase policy impact. Despite a lack



of comprehensive data and information, Newman and Page (2017) identified 29 cases of successful SEZs in 27 African countries. Many of these zones have high capacity utilisation rates and have created jobs, although not enough for all new entrants to the labour market. Notable features of these SEZs include providing business support services, facilitating employment with long-term visas and work permits, and introducing flexible recruitment laws.

Ethiopia hosts a number of industrial parks and is creating more. Currently the parks operate at high capacity, target domestic and foreign manufacturers and comprise a mix of publicly and privately built facilities (IPDC, n.d.; Ethiopia EU, 2016). A pilot country programme in collaboration with international stakeholders underscored the need for a holistic approach to inclusive industrialisation. As a result, Ethiopia is building Integrated Agro-Industrial Parks (IAIPs) in four regions of the country (Ethiopia Country Note, AEO 2017).

In Kenya, investments are underway for industrial parks in the logistics and leather sectors. The projects benefit from the strategic importance of Mombasa's port, the abundance of cattle providing raw material and low labour costs (World Bank, 2015a).

Some SEZs could perform better. According to a survey of 91 SEZs in 20 sub-Saharan African countries, SEZs account for only 0.2% of national employment (Farole 2011; Kingombe and te Velde, 2015). Some SEZs have created a "race to the bottom" between neighbouring countries, relying solely on tax incentives to attract industries and investments rather than aiming to improve the general business climate. SEZs have also underperformed for other reasons which governments should try to avoid when promoting SEZ-based industrialisation in the future:

1. limited linkages and knowledge transfers with the domestic economy (Newman et al., 2016)
2. inconsistency with a country's comparative advantage and inefficient location choices (Monga, 2011)
3. crowding-out of private investors (as in Tanzania)
4. bottlenecks from limited policy co-ordination (as in Lesotho) (AfDB/OECD/UNDP, 2015)
5. cumbersome customs clearance procedures and inadequate infrastructure (e.g. unreliable electricity provision) (Farole, 2011).

Additionally, many clusters in Africa are static and do not go beyond their survivalist nature (Morris and Kaplinsky, 2015). Low rates of innovation in such clusters can be ascribed to the overlap of strong social ties with business networks and adherence to sub-optimal transactional and organisational models (Taura and Watkins, 2014). Further, many clusters in Africa have emerged spontaneously and with little policy support. This means that the quality of infrastructure and public goods can be extremely low, hampering the growth of African firms.

Clusters need public goods to thrive

The effectiveness of clusters depends on many conditions. Adequate infrastructure and services must be available to ensure proximity to customers and markets. The firms' products must be in line with the clusters' latent comparative advantages. Finally, linkages between firms of the cluster and the surrounding local economy must be strong.

Clusters without adequate infrastructure and public goods may suffer from congestion and can increase firms' costs. In Ghana, the high demand for the Suame Magazine cluster's services increased the number of its firms. However, due to congestion from a lack of public goods and infrastructure, sales revenues decreased (Idrisu, Mano and



Sonobe, 2012). Congestion can also deter firms from locating in a specific cluster, as in the case of Tunisia's industrial sector. While a higher number of firms in the cluster increased competitiveness and had positive effects on firm performance, congestion resulted in approximately 4% fewer new entrants in the same cluster (Ayadi and Mattoussi, 2014). Firms in Nigeria's Nnewi cluster had to invest in roads, water and electricity on their own. This increased the firms' overhead costs and reduced their ability to invest in research and development (R&D), skills, and technical upgrading (Morris and Kaplinsky, 2015).

The road network can affect firms' location decisions and determine cluster success. An analysis of road quality and formal manufacturing firms with at least ten workers found that towns in Ethiopia with an improved road network attracted a larger number of firms. Specifically, reducing travel time to a given town by 1% led to a 1.2% net increase in the number of manufacturing firms established in that town. Enterprises tended to relocate from more established manufacturing clusters, which saw their share of manufacturing firms decrease from 77% in 1997 to 55% in 2009 (Shiferaw et al., 2015). In the furniture cluster in Arusha (Tanzania), output growth was highest along a major traffic route connecting Arusha to Dar es Salaam and Nairobi (Kenya) (Muto, Chung and Shimokoshi, 2011).

Clusters can also help informal firms transition into the formal economy

Industrialisation strategies need to empower even informal clusters. Most of the clusters reviewed for this section are informal agglomerations of MSMEs. In many cases, firms may interact with one another on the basis of trust and kinship rather than contracts. In the Nnewi automotive cluster, kinship provides a guarantee of loan repayments (Brautigam, 1997). The Suame Magazine Industrial Development Organization (SMIDO) was created to address the lack of government support to the cluster and the provision of welfare to its entrepreneurs and workers (Gatune 2016). In Addis Ababa (Ethiopia), the requirement for evidence of tax compliance and loan repayment history excluded most MSMEs from a public programme which included financial support and business mentorship (Ali, 2012).

The Otigba ICT cluster in Nigeria provides an example of a first step towards bringing clusters into the formal sector. The cluster emerged spontaneously as an informal agglomeration of small enterprises in a residential district in Lagos. Generally, the Lagos State Government had tried to deter the establishment of informal firms rather than incite them to enter the formal sector (World Bank, 2016a). The government, however, now recognises the existence of the cluster, dialogues with the umbrella organisation representing its firms and collects taxes from them (Oyelaran-Oyeyinka, 2014).

Linkages with educational facilities can boost clusters. A renowned public university established a training facility near Suame Magazine in Ghana which guaranteed the cluster's survival amid growing competition from imported products. Training, exchanging ideas and transferring technology with foreign experts and practitioners has led to innovation by entrepreneurs and increased workforce specialisation in Tangier (Morocco) (Gatune, 2016). Similarly, the provincial government in Tangier is heavily involved in setting up skills training centres and facilitating exchange between local universities and the FDI firms in the Tangier-Med clusters (Cech et al., 2015).³

Access to markets can generate opportunities for entrepreneurs. Lesotho's apparel sector thrived and upgraded to regional and global value chains because of the country's preferential access to South Africa and the United States (Morris and Staritz, 2016). The sector achieved more stability following investments from South Africa. These investments were due to an existing cluster, around Lesotho's capital, which had been set up to exploit the country's duty-free access to the US market. Thanks to these inflows,

the cluster reached an employment peak of 53 000 in 2004 (Morris, Barnes and Kao, 2016).⁴ Other successful clusters such as Otigba in Nigeria have strong linkages both within the cluster and with external firms, domestically and in the region (Zeng et al., 2008).

Box 8.4. Nigeria's online movie entrepreneur Jason Njoku

As part of Nigeria's growing film and music industry,⁵ in 2010 the 32-year-old entrepreneur Jason Njoku founded the company Iroko Partners. He created it in response to the inaccessibility of Nollywood films and other media content online.

In early 2011, the company had secured online rights to 500 movies from 100 different one-man production houses. Following a content partnership with YouTube (the first of its kind in Africa), Iroko Partners provided full-length Nollywood movies online. The following year, Iroko Partners launched its own platform, iROKOTv and in less than 6 months reached 500 000 registered users. Within a year the platform counted 152 million views, 90% of which originated from abroad.

After different international media outlets interviewed Jason Njoku, his business came into the spotlight. It raised USD 8 million in venture capital. Currently, the company is Africa's largest distributor of Nigerian movies and provides jobs to 91 workers based in England, Nigeria and the United States.

Source: Moudio (2013); Nsehe, (2012); African Business Central (2015).

Clusters are providing a growing range of services for start-ups

A growing range of spaces with support services is available for start-ups. Africa counts over 300 business incubators, accelerators, seed capital hubs, tech hubs, impact hubs and start-up academies.⁶ These co-working spaces provide resource-constrained entrepreneurs with the essential services needed to carry out their work. They offer work space, Internet, technical support, business planning and advisory services, market linkages, and help to obtain financial support. The services vary in quality and are concentrated in urban centres.

Business incubators and accelerators play a key role in bringing together firms and providing training and infrastructure funding. Incubators and accelerators assist early-stage firms (see Figure 7.1 in Chapter 7) until they acquire sufficient resources and market momentum to function autonomously. Evidence from a number of OECD countries shows that the impact of business incubators on firm survival has been generally positive (OECD, 1999). An evaluation of nine incubators in Central Asia and Europe indicated that incubators stimulate sector and cluster development as well as increase firm survival rates (80% after one year) (World Bank, 2014).

Firms need better public services. A Monitor Group survey shows that only 30% of entrepreneurs in Kenya and less than 25% in five other countries surveyed believe that business support services are sufficient to meet the needs of new firms (Omidyar Network/Monitor Group, 2013). Since 2010, Africa has witnessed a high turnover in incubators and start-ups. Nevertheless, they have grown by about 15% since the start of 2014. In general, such spaces supported by a variety of stakeholders perform better than those by government, the private sector or academia alone (World Bank, 2016b). The table in Annex 8.A1 offers an overview of the incubators that are active throughout the continent.

Policies need to build on economic strengths

Governments can support entrepreneurs through well-targeted policies. This will increase countries' competitiveness, both domestically and globally, as well as bring higher returns on capital investment. In the context of industrial development, governments



should focus on providing market information, co-ordinating investments made in the same industry, reducing first-mover risk to promote innovation, and fostering new industries through FDI promotion and firm incubation (Lin, 2011).

Adopting new technologies would allow countries to jump-start their industrialisation in sectors that are already at least partially developed (Naudé, forthcoming). This approach is not equal to “picking winners” or even creating them. Rather, governments can focus on sectors with high levels of competition or linkages to the rest of the economy that may offer important returns on policy (Rodríguez-Clare, 2004). Additionally, governments could assess whether to give the status of SEZs to established clusters (e.g. Centre for Development and Enterprise, 2016). Governments could thus apply preferential tax regimes and streamlined procedures for infrastructure investment to boost industrialisation (Gatune, 2016).

Clusters can offer both firms and governments a favourable environment for successful entrepreneurship and industrialisation. Gains from agglomeration economies and strategic localisation can benefit firms, while focused interventions based on existing economic and market strengths can increase the effectiveness of public policy. Research points to the need for governments to follow the competitive advantages of the domestic economy. In particular, there is scope for government intervention in providing enabling infrastructure, in developing skills and in establishing business networks and market linkages, including through engagement with local administrations.

Promoting existing clusters may be more effective than establishing new ones

The role of policy is to build on existing industrial strengths rather than establish clusters from scratch (Enright and Ffowes-Williams, 2000; Benner, 2012). Successful African clusters have typically emerged spontaneously as a result of direct entrepreneurial decisions rather than state planning (Benner 2012; Otsuka and Sonobe, 2011). Some research proposes that cluster development be led by the private sector, with the government providing policy support and public goods as a facilitating mechanism (Lin, 2012; Otsuka and Sonobe, 2011; AfDB/OECD/UNDP, 2016).

Governments play a part in establishing private business networks. The South African government was instrumental in bringing firms together in industrial associations in the apparel and automotive sectors that were precursors to fully developed clusters. It did this mainly by funding official associations, which led to information exchanges and cost-saving synergies, for example in training workers (Morris and Barnes, 2007). Local governments can be in a better position to engage with enterprises and support their growth. In the case of South Africa’s Durban Automotive Cluster, the eThekweni Municipality acted on behalf of the central government and benefited from a closer interaction with firms located in the cluster. This resulted in a more sustained and effective dialogue, and in the implementation of pro-business policies which contributed to the growth of the cluster (Morris and Barnes, 2007).

Priority actions differ depending on the type of country:

- **Natural resources-based countries** could use commodity revenues to provide public goods (particularly infrastructure) to clusters with the potential to diversify the economy, foster domestic linkages, attract FDI and increase employment. These countries could also build on their rapid urbanisation to support clusters catering to urban-based consumers and thus promote economic diversification.
- **Fragile states** could benefit from foreign investment and donor support to provide basic infrastructure and public goods to clusters. Business clusters could favour the

growth of vibrant entrepreneurial activity despite the fragile business environment. Multiple levels of governments, private actors and the international community could co-operate to design context-specific policies in those clusters. There is a risk, however, that such clusters become isolated from the surrounding area.

- **Low-income countries** could promote clusters that connect them to the international economy. Reducing the costs of doing business in a country is one way to promote such clusters. Making clusters more efficient via public goods and infrastructure (e.g. roads and electricity) could improve competitiveness and incentivise firms to participate in public procurement tenders and other contracts. As they attract more companies, such clusters could upgrade their activities and become more sophisticated. Developing backward and forward linkages with other economic sectors and regions will likely fuel their growth.
- **Middle-income countries** could upgrade certain clusters into industrial parks and SEZs to develop activities with more value added. Where the population has special skills, clusters can attract foreign investment and can transfer knowledge and capital to the local economy. Locating such areas next to logistical hubs can attract diverse activities.

Diversified financing solutions can channel resources to African entrepreneurs

Developing financial markets can enable the private sector to invest more. Private firms face high borrowing costs which hamper their growth. One reason is that in underdeveloped financial markets, credit providers may prefer lending to governments, which is seen as less risky (AfDB/WB/WEF, forthcoming).

Worsening macro-economic and banking sector conditions widen financing gaps, increasing the need for new solutions (AfDB/WB/WEF, forthcoming). The AfDB (2013) argues for a holistic approach that targets several levels: from improving the business environment to enhancing the market functioning of financial services and increasing their variety, to direct financing of high-growth firms. Adopting such an approach entails improving the investment climate and financial infrastructure and supporting financial institutions. It also means working directly with entrepreneurs to improve their creditworthiness, financial literacy and growth potential.

Entrepreneurs starting a new business need seed capital. As these young firms are often risky, equity finance can meet their needs. In OECD countries, research shows that young firms often face a credit crunch 12 to 24 months after their creation. At this point, the entrepreneurs have exhausted their personal resources, and their firms may be too small to qualify for formal banking loans.

Regulatory frameworks can encourage a variety of loan organisations

To promote lending to firms, regulatory frameworks should acknowledge the different types of funding institutions. Legal frameworks need to differentiate between banking, co-operatives, microfinance institutions and other financial organisations (Akande, Abu and Obekpa, 2016). Competition and credit provision can increase when non-banking institutions also offer secured loans (see Chapter 5). A clear regulatory framework can foster asset-based services, such as factoring and leasing (Klapper, 2006). In particular, specific regulatory interventions can include the following:

- Timely bankruptcy procedures and strong contract enforcement to reduce downside risks for entrepreneurs (Calvino, Criscuolo and Menon, 2016).

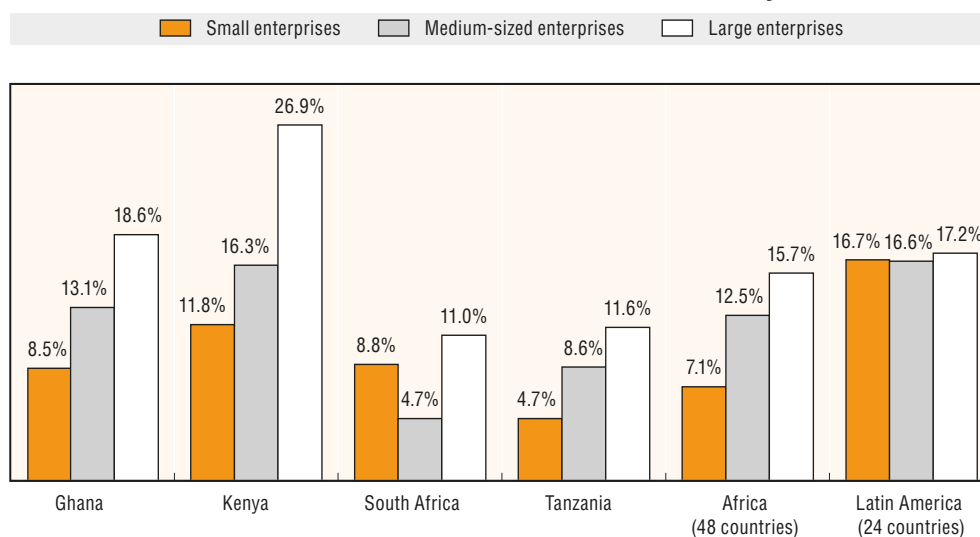



- A streamlined and tailored tax system to ease the compliance burden for young firms and encourage them to formalise, thus giving them access to formal credit (Stern and Loerprick, 2007).⁷
- More developed information systems. Credit information bureaus and registries can ease constraints faced by SMEs (Stein, Bilandzic and Hommes, 2013). Several African countries have already implemented reforms such as creating systems to register property and to share credit information (see Chapter 5).
- Institutional frameworks specifically targeting SMEs. A dedicated SME authority and business associations could facilitate SMEs' relations with credit providers (Nahamya et al., 2013).
- Government investments or other financial incentives in R&D, particularly for innovation-led enterprises. This would at least partially absorb firms' costs (Arvanitis, 2015).

Traditional financing institutions may need support to increase lending to firms

Traditional financial service providers have overly avoided taking risks in financing SMEs and innovative firms (Arvanitis, 2015). In general, African firms are 19% less likely to have a bank loan, even after controlling for firm characteristics. Small enterprises are 30% less likely to obtain bank loans than large ones, and medium-sized enterprises are 13% less likely (Beck and Cull, 2014). In a survey of over 3 000 SMEs and 18 commercial banks in Nigeria, KPMG/EDC (2014) found that two-thirds of the banks had rejected over 50% of loan applications submitted by SMEs.

Figure 8.6. Proportion of working capital financed by banks in selected African countries and Latin America, 2015 or most recent year



Source: Adapted from Enterprise Surveys, www.enterprisesurveys.org.
StatLink  <http://dx.doi.org/10.1787/888933475544>

Credit guarantee schemes (CGSs) could encourage banks to lend more to firms. CGSs are examples of successful co-operation between entrepreneurs and commercial banks, donors, governments and non-governmental organisations. A global comparison of different lending schemes found that CGSs are less likely to generate market distortions and are more consistent with a well-functioning banking system (IFC, 2010). However, for CGSs to flourish, the banking sector and the overall economy must host the necessary conditions (Benett, Doran and Billington, 2005).

Stakeholders in CGSs developed 16 key principles for an effective design. Among these, noteworthy principles for policy makers include:

- establishing CGS providers as independent legal entities
- adopting clear and transparent eligibility criteria for SMEs
- supervising and evaluating CGSs' effectiveness by independent entities
- ensuring that the claim management process of CGSs is efficient, clearly documented and transparent, so as not to discourage credit providers from seeking to recover losses (World Bank/FIRST, 2015).

The success of CGSs highly depends on their design. Effective CGS providers tend to disburse funds immediately or deposit the guarantee funds in the participating bank in advance; this reduces the operation costs for banks and increases utilisation rates (Dalberg/AFD, 2012). CGSs also need a non-disclosure clause for the borrower to limit the risk of moral hazard (AFR, 2015).⁸ Many local banks would benefit from capacity training to improve their credit risk assessment procedures for small and young firms. Credit guarantee providers can combine financial support with giving advice. This is the case of the AfDB that supports the Bank of Industry in Nigeria to promote lending to SMEs.⁹

Box 8.5. The African Guarantee Fund

The African Guarantee Fund for Small and Medium-sized Enterprises (AGF) provides a successful example of the financial viability of a credit guarantee scheme. AGF was set up in 2011 by the AfDB, the Danish international development agency (Danida) and the Spanish Agency for International Development Cooperation; the Agence Française de Développement (AFD) joined more recently. By the end of 2015, USD 230 million worth of guarantees had been signed. Commercial banks increased this amount, by leveraging the USD 230 million in guarantees to lend out USD 460 million to SMEs.

The credit guarantee scheme has benefited more than 1 300 SMEs, generating over 11 000 jobs. The fund operates in 35 African countries, with 54% of the credit guarantee capacity spent in West Africa and 22% in East Africa. After only three years of activity, the fund became profitable and reached break-even point. Revenues quadrupled between 2013 and 2015, from USD 2 billion to USD 9.1 billion.

Source: AGF (2015).

New financing instruments for private investment need to be developed

Multiple new types of financial instruments can contribute to diversifying the financial solutions available to African entrepreneurs. These instruments include asset-based lending, various types of private equity funds and listings, and social investment funds. Other such investments are “profit with a purpose” funds, multiple types of debt instruments, micro-finance for SMEs, crowd-funding, various solutions provided by development financial institutions, and philanthropic finance targeting SMEs and entrepreneurs.

Asset-based lending such as factoring and leasing can bolster a firm's cash flow while removing the stringent requirements associated with traditional credit. Factoring refers to a firm selling its accounts receivable to a financial intermediary for immediate cash. Factoring can alleviate firms' problems with limited cash flow while doing away with collateral requirements. Burkina Faso has a successful programme that uses a mix of private capital and donor contributions (Nakusera, Kadhikwa and Mushendami, 2008). As for leasing, firms can acquire machinery and equipment without making large investments or providing collateral.



Private equity is increasingly bringing funds to entrepreneurs. Private equity (PE) encompasses venture capital, angel investments, mezzanine finance and other private financial solutions. PE funds can improve an enterprise's performance. AVCA (2016) figures show that despite still playing a limited role, PE investments in Africa are growing. The increase is attributable to steady policy reforms and an improved investment climate since the 2000s (Babarinde, 2012). From 2010 to June 2016, the value of total PE deals in Africa reached USD 22.7 billion. In South Africa, PE funds reached 0.2% of GDP in 2015, a level similar to South Korea and higher than Brazil and Poland (SAVCA/KPMG, 2016). Investors are expanding into Kenya and Nigeria, and the positive effects of this interest are expected to be visible in the next five to ten years (Ernst and Young, 2014).

For SMEs in countries with deep capital markets, equity listings can constitute an alternative source of finance. Listing requirements are usually less stringent and costs are lower compared to those for larger companies. Africa has 14 equity exchanges for SMEs,¹⁰ with over 200 firms listed (Minney, 2016). The Johannesburg Stock Exchange (JSE) established the first SME-tailored trading platform in 2003. As of 2016, a total of over 120 firms were listed, a quarter of which “graduated” to the JSE Main Board. The challenges with SME equity listings are information asymmetries for investors and a lack of know-how and expertise by entrepreneurs and managers. If enforced, the existing transparency requirements would address the first issue. Certain equity exchanges solve the second by appointing advisors to guide SMEs through all the steps leading to the listing (Minney, 2016).

There are also multiple non-profit social investment funds and “profit with a purpose” funds that offer capital at affordable rates. The individual fund size ranges from USD 4 million to USD 150 million, with an average size of USD 29 million (UNDP, 2014). Many of these investment packages combine capital and business development services, which can minimise investment risks. The majority of funds have at least one development finance institution as a limited partner. Additional sources of capital come from private individuals and companies, foundations, pension funds, insurance companies, and commercial banks.

Donors and philanthropic actors are increasingly moving towards more innovative financial solutions, including impact investing, although often as a complement to existing sources of finance. An investor survey shows that global impact investors are allocating the largest portion of their portfolio to sub-Saharan Africa and plan to further increase this share (GIIN and J.P. Morgan, 2014). According to the UK Department for International Development, impact investment in sub-Saharan Africa surpassed USD 11.6 billion in 2014 alone, accounting for 22% of global impact investment (DfID, 2015). Egypt, Kenya, Morocco, Nigeria and South Africa are leading the way. Investment is also increasing in other countries such as Ghana, Mozambique, Tanzania and Zambia.

Debt instruments can help firms and governments tap financial markets. Despite low capitalisation and limited investor pools, African debt and equity markets can potentially support the continent's industrialisation (UNECA/AU, 2013). Corporate and sovereign debt instruments can help make up for the lack of long-term finance needed for private and public investments. Governments in particular can opt for infrastructure bonds, diaspora bonds or remittance bonds (Adeoye, 2014).

Microfinance loans, though controversial, can support SMEs. By and large, microfinance has had mixed results in improving living conditions and business performance (Stewart et al., 2010). Microfinance is intended to provide loans to individuals who are not served by the banking sector. Some people consider microfinance as “anti-developmental” (Bateman and Chang, 2012) as its high interest rates can exacerbate entrepreneurs' financial difficulties (Karnani, 2007). African microfinance institutions

(MFIs) generally suffer from weak governance, poor portfolio management, unskilled employees and unsustainable lending. Moreover, support services are rarely offered and often lack quality (UN, 2013). On the upside, all respondents in a survey of Nigerian SMEs recorded increased market share and improved competitiveness from microfinance. Another survey, this time of Ugandan SMEs, found that microfinance loans are used to increase merchandise stock and employ more people. Specifically, an increase in their loan size led to a 1.3% rise in the firms' employment levels and an inventory growth of 141.5% (Nahamya et al., 2013).

While still a niche solution, crowd-funding can help entrepreneurs. Crowd-funding is a way of seeking financial means through the Internet from the general public (the "crowd") instead of approaching financial investors such as banks, business angels or venture capital funds. It allows entrepreneurs to tap into their networks and have access to capital located anywhere in the world. Africa still represents a small fraction of the global crowd-funding market. Estimates for 2015 put the value of the African crowd-funding market at 21% of emerging market volumes and 0.5% of global activity (World Bank, 2015b). The low uptake in crowd-funding activities in Africa can be attributed to a combination of practical and regulatory barriers. These include limited Internet and social media usage compared to other world regions, high costs of transferring money to and within Africa, and a lack of regulation and standards on new payment technologies, on cross-border electronic payments and on the transfer of equity ownership (Berndt, 2016).

A noteworthy example is that of Togolese entrepreneur Afate Gnikou. He used crowd-funding to raise the capital for a prototype 3D printer from recycled electronic waste in Togo. The printer, which sells for less than USD 100, won Gnikou an international prize for manufacturing (Scott, 2015).

Development financial institutions (DFIs) can help foster stable and sustainable economic activity (Ferraz et al., 2013). In Africa, public DFIs can complement long-term finance, especially for SMEs. DFIs have historically contributed to economic development by taking higher risks than the industry average (Calice, 2013).

However, African DFIs have a mixed track record. A global survey of 90 institutions from 61 countries found that most DFIs perform poorly in terms of governance and risk management. They also remain vulnerable to political interference and capture by interest groups (De Luna-Martínez and Vicente, 2012). In addition, their lending activities are relatively inefficient and ineffective. Nevertheless, DFIs equipped with strong governance structures and the right incentives can expand financial access and support industrialisation (Calice, 2013).

Direct financing and support can help high-growth firms realise their potential

Providing capital directly to entrepreneurs increases their growth and creates more jobs. While it is almost impossible to identify which firms will grow quickly in the future, it is possible to identify those with a high potential for growth (McKenzie et al., 2017; Nanda, 2016). A large-scale national business plan competition in Nigeria provides evidence of this approach. Each winning entrepreneur was awarded approximately USD 50 000. Surveys tracking applicants over three years showed that winning led to greater firm creation and survival rates. The winners' firms enjoyed higher profits and sales than the others and an increase of over 20 percentage points in the likelihood of employing 10 or more workers (McKenzie, 2015).

Development partners can directly support entrepreneurs through co-financing and advisory services. For example, the AfDB's Souk At-Tanmia initiative provides



entrepreneurs financial support as well as technical assistance in the form of coaching and mentoring. The initiative involves partners from both public and private sectors. In its two editions (July 2012 and April 2014), Souk At-Tanmia assisted 161 entrepreneurial projects, disbursed around USD 2.7 million in grants and mobilised USD 5 million in additional resources. The initiative expects to create over 1 300 jobs. Private philanthropies, such as the Tony Elumelu Foundation, provide seed capital and mentoring to over 200 technology start-ups and conventional firms that could adopt industrial production methods across Africa.

Remittances and return migration can boost investment

Migrants can foster entrepreneurship in their countries of origin by funding firms with their remittances or becoming entrepreneurs themselves on their return (see also Chapter 2). Remittances contribute to establishing firms, as shown in the cases of Côte d'Ivoire and Ghana (Black and Costaldo, 2009), Egypt (McCormick and Wahba, 2001), and Tunisia (Mesnard, 2004). Moreover, these expatriated savings help overcome domestic credit constraints (Naudé, Siegel and Marchand, 2015). Work experience accumulated abroad can have an even stronger effect on entrepreneurship than remittances (Black and Costaldo, 2009; McCormick and Wahba, 2001).

Migrants returning to their home countries may have a double advantage as entrepreneurs. In many cases, migrants are exposed to competitive environments abroad and bring home new skills and ideas (Severino and Hajdenberg, 2016). At the same time, their emotional links with their home countries and their indigenous knowledge help them move into the market more efficiently than non-native investors (Wolff and Opoku-Owusu, 2016). Evidence from Egypt suggests that the migration experience increases survival rates of newly founded enterprises (Marchetta, 2012).

However, three factors can affect the success of these diaspora entrepreneurs:

1. Migrants face a trade-off between accumulating financial and human capital and losing their social networks, which are important for new entrepreneurs (Wahba and Zenou, 2012).
2. The productive advantage of migrant entrepreneurs tends to be higher only for those individuals returning from countries where they can gain more skills or wealth, as in the case of migrants returning from OECD countries to West Africa (De Vreyer, Gubert and Robilliard, 2010).
3. After setting up their enterprises, returning migrants, like any other entrepreneur, still face many of the challenges typical of environments that are not conducive to business. For example, returning entrepreneurs in Algeria, Morocco and Tunisia still cited capital constraints as a major obstacle (Gubert and Nordman, 2011).

Governments can strengthen the nexus between migration and entrepreneurship by improving the business environment. This includes streamlining regulatory procedures for small and medium-sized entrepreneurs and establishing one-stop shops that provide information on opportunities for migrants' investments. The Ghana Investment Promotion Centre, for instance, offers a one-stop shop for diaspora members who wish to invest in the country (see also Chapter 2).

In addition, governments can improve the technical skills of diaspora entrepreneurs. In particular, they can provide coaching and mentoring services to women- and youth-led start-ups and social enterprises. Governments can also target financial products to these groups (Wolff and Opoku-Owusu, 2016).



Co-operation between governments, development partners and the private sector is key to increase entrepreneurs' access to finance

The potential for private investment in developing countries is substantial. Globally available finance is estimated at USD 120 trillion (Woetzel et al., 2016). Official development finance (ODF) amounts to about USD 2 billion per year, while developing countries across the globe need an estimated USD 2.5 trillion per year to achieve the Sustainable Development Goals.

Development partners therefore increasingly use ODF to build up private investment for development. For instance, multilateral development banks claim that for every USD 1 they extend directly to the private sector, USD 2-5 of additional private sector investment are mobilised (AfDB et al., 2015: 2). Initiatives such as Boost Africa, jointly launched by the AfDB, the European Investment Bank and the European Commission, allow mobilising private capital through initial public investments. In this case, the EUR 150 million that the three institutions contributed are expected to generate EUR 1 billion in additional investments.

In addition, development partners provide financial assistance to governments and national development banks to on-lend to private companies. This can also generate considerable resources. For example, a study shows that USD 1.4 billion in financing from the Clean Technology Fund to the public sector has mobilised about USD 5 billion of private co-finance (CTF, 2013).

Other approaches include project preparation facilities and facilitation platforms. Project preparation facilities serve to design well-structured bankable projects. Project facilitation platforms match the interests of public and private financiers in carrying out joint projects. Examples include Grow Africa, an initiative of the African Union Commission, the New Partnership for Africa's Development and the World Economic Forum. Grow Africa provides a platform for governments and companies to promote business models that engage smallholder farmers and facilitates value-chain linkages. It focuses specifically on women and youth.

Prioritising specific policy interventions depends on countries' resources and capacities. The conditions differ between countries, based on their natural resources' endowment, their fragility and their income levels:

- **Natural resources-based countries** may wish to create funds with the profits from natural resource extraction, transformation and export to promote entrepreneurship. Governments could also foster financial sector development through laws and regulations. Donors could assist governments in managing the funds or in designing related regulations, as in the case of the multi-stakeholder Managing Natural Resource Wealth Trust Fund (IMF, 2016).
- **Fragile states** may wish to seek private sector investment and donor assistance to build government capacity and engage with entrepreneurs.
- **Low-income countries** could seek donor assistance to build government and private sector capacity and to develop financial markets through guarantees and funding. In countries where remittances are important, tailored regulation and policies could attempt to tap their potential.
- **Middle-income countries** could diversify their market environment with holistic financial sector laws and regulations as well as supervision that targets different agents and instruments. These countries could likewise request donor support to increase government and private sector capacity and market development, particularly through credit guarantees or by tapping domestic and international financial markets.



Annex 8.A1. Active start-up incubators in Africa

Country	Hub
Algeria	Pépinières d'entreprises (under the Ministry of Industry and Mines)
Angola	National SME Support Institute
Benin	e-TRILABS, Jokkolabs Cotonou
Botswana	Botswana Innovation Hub, First Steps Venture Center
Burkina Faso	Yam Pukri, Jokkolabs Ouagadougou
Cameroon	ActivSpaces
Congo	BantuHub
Côte d'Ivoire	Jokkolabs Abidjan, W Hub, Akendewa
Congo, Dem. Rep.	Mwasi Tech Hub, Imani Hub
Egypt	Cairo Hackspace, The District, Flat6Labs
Ethiopia	IceAddis, xHub Addis
Gambia	Jokkolabs Banjul
Ghana	mFriday, Meltwater Entrepreneurial School of Technology, gSpace
Kenya	iHub, mLab East Africa, GrowthAfrica
Liberia	iLab Liberia
Madagascar	I-Hub Malagasy, Habaka, INCUBONS, Centre d'Excellence en Entrepreneuriat (CEENTRE), Century Reliable Partners (CRP)
Mali	Jokkolabs Bamako
Malawi	mHub, Malawi
Mauritius	Ebene Accelerator
Morocco	Jokkolabs Casablanca, New Work Lab, Espace Bidaya, Pitch Lab, Dare Inc
Mozambique	MICTI Technology and Business Centre
Namibia	Namibia Business Innovation Centre (NBIC), Fablab Namibia
Nigeria	L5 Lab, Co-creation Hub, Wennovation Hub
Rwanda	kLab, The Office, 42Kura
Senegal	Jokkolabs Dakar, CTIC Dakar, Africa Living Lab; E-Cover
Seychelles	Providence Industrial Estate (includes the micro-enterprise complex "Leve Debrouye")
Sierra Leone	AFFORD Sierra Leone
South Africa	Jozihub, Capetown Garage, Black Girls Code, Shanduka Black Umbrellas, Raizcorp, The Innovation Hub
Sudan	Family Bank has a consortium with Sudan University of Science and Technology (two locations), Graduate Employment Fund (two locations) and Agricultural Research Corporation (two locations)
Tanzania	Kinu Innovation and Co-Creation Space, TANZICT
Togo	Woe Lab, Ecohub, Innov'Up
Tunisia	Wiki Start-Up
Uganda	HIVE colab, @TheHub Kampala, The Outbox Hub
Zambia	Bongohive Zambia
Zimbabwe	Muzinda Hub, Emerging Ideas, Neolab, Moto Republik

Source: Adapted from World Bank (2016b) and contributions by AfDB country economists.



Notes

1. Adapted from IFC's *Enterprise Finance Gap Database*.
2. A review of Integrated Entrepreneurship Education (IEE) teaching in secondary schools in Botswana, Kenya and Uganda did not find any conclusive evidence of positive effects on entrepreneurial activity. While TVSD students were on average more inclined to start a business than general secondary students, it is unclear whether this was attributable to IEE courses (Farstad, 2002).
3. Outside of Africa, the success of the Porto Digital IT cluster in Recife (Brazil) hinged on the presence of academic and training institutions in addition to ICT incubators. The business ecosystem developed around these centres of knowledge in the early 2000s and created a cluster of 260 firms employing over 8 000 workers and with combined revenues of over USD 400 million (Felipe, 2016).
4. Subsequently, the sector and cluster suffered from the phasing out of the Multi Fibre Agreement (MFA) in 2005 (see Chapter 6), with employment decreasing to 39 000 workers in 2012.
5. The Nigerian film and music industry has become one of the country's largest employment-absorbing sectors. It accounts for approximately 1.4% of GDP (Omanufeme, 2016).
6. These spaces can constitute a first step towards agglomeration as in the case of Chile, which aims to turn three secondary cities into innovation hubs (OECD, 2016).
7. Morocco created a legal status for own-account workers (*auto-entrepreneurs*) and simplified the legal procedures for these entrepreneurs.
8. Access to Finance Rwanda cited this feature as an important success factor of its Agricultural Credit Guarantee Scheme.
9. <https://www.afdb.org/en/news-and-events/article/afdb-approves-a-financial-package-of-usd-500-million-for-the-bank-of-industry-nigeria-8045/> (accessed 20 January 2017).
10. www.africatrictlybusiness.com/lists/stock-exchanges-small-and-medium-enterprises, (accessed 19 January 2017).



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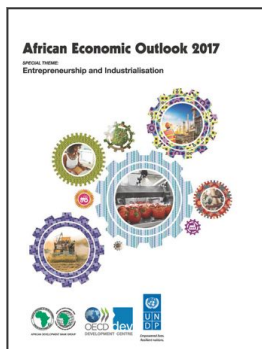
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