



Economic Commission for Africa

Enhancing the Competitiveness of Small and Medium Enterprises in Africa:

A Strategic Framework for Institutional Support



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I. Introduction

1. A key issue for Africa's economic future is whether and how local enterprises benefit from the liberalisation and globalisation of product markets. Most enterprises are of small or medium size and the problems they face fall into two categories: First, *access*: can they participate in production for regional and global markets or do they remain excluded? Second, *upgrading*: does inclusion lead to upgrading or does it lead into a race to the bottom? This report examines the institutional framework in which African SMEs try to compete. Where does it help them to gain access to distant markets and upgrade? Where does it hold them back? What changes are needed? What good practices can policymakers build upon? What are the priorities for action? These are big questions for which there are no easy answers. The problems are many, but in some countries there have been significant improvements. African experiences are diverse. While recognising this diversity, this report seeks to answer the above questions and move towards a strategic framework for supporting African SMEs.

2. For this purpose, the constraints faced by SMEs are examined, good practices are identified and priorities for action are recommended. The identification of constraints and good practices covers the following areas:

- *The regulatory and policy environment*: to what extent is it enabling or disabling?
- *Infrastructure*: in which areas is it deficient?
- *Access to finance*: does it extend to SMEs?
- *Support services* for technology, skills development, and marketing: where and how do they need to be strengthened?

3. The report is organised as follows: for each of the above blocks of issues, it

- summarises the main lessons from the international experience;
- provides an overview of the strengths and weaknesses in 13 African countries;
- gives examples of good and bad practices.

4. The analysis is wide ranging but gives most attention to failures and solutions in the provision of support services for SMEs.

5. This represents the core of the report, which is presented in Sections 4 to 7. It is preceded by an overview of industrial development in Africa, provided in Section 2, which stresses the changes in export markets and identifies some of the key factors explaining the weak response to the new challenges. Section 3 presents an analytical framework for analysing and fostering SME development. This framework structures the analysis in Sections 4 to 7 outlined above. Finally, Section 8 pulls together the key points emerging from the analysis of constraints and policy experiences before

discussing ways of prioritising the next steps for African policymakers and practitioners.

6. The preparation of this report was preceded by extensive empirical work carried out in 13 African countries by officials of the Development Management Division of the Economic Commission for Africa and complemented by the work of local consultants. Rapid appraisals of policies and support services were carried out in

- Morocco and Senegal by Ms Awa Fall, ECA;
- Mauritius, Namibia and South Africa by Mr Asmelash Beyene, ECA;
- Ethiopia and Uganda by Mr M K Mwangi, ECA;
- Côte d'Ivoire and Kenya by Mr Barry Ibrahima, ECA;
- Cameroon, Gabon, by Mr Pierre Demba, ECA;
- Nigeria by Mr Inyang E Inyang, local consultant;
- Tunisia by Mr Mounir Zalila, local consultant.

7. The findings from these reports are only presented in summary or selective form, but they provided a key input into the preparation of this study.

II. Industrial Development in Africa: an Overview

8. This overview stresses the changes in the nature of global competition over the last two decades and then identifies some of the key factors which explain why African economies have been less successful than those of other developing countries in responding to the new competition.

A. Changing export markets

9. For most industrial enterprises in developing countries, the 1990s are different in two respects from previous decades: competition is more intensive and it is waged over a wider range of factors. While price continues to be important, quality, speed and flexibility matter more than before. Due to the twin forces of liberalisation and globalisation most enterprises have little choice but to confront these pressures.

10. Compared with enterprises in advanced countries, producers in developing countries have the advantage of lower wage costs. Indeed, during the 1970s and 1980s this enabled them to conquer a share of the market from advanced-country producers, particularly in labour-intensive sectors such as garments, footwear or toys. But conditions changed in the 1990s. Countries with even lower wages entered global markets, notably China. Simultaneously, global buyers insisted on better quality, faster responses, and smaller batches. Many developing-country producers felt that they were expected “to produce at Third World prices to First World standards”. Indeed, this sums up the challenge faced by an increasing number of enterprises in developing countries, whether they are competing against imports or catering for export markets.

11. Some countries in Latin America and Asia have been able to respond to this challenge but African countries have not, with very few exceptions. Some of the factors explaining this difference are identified below. This analysis sought to examine the region’s exports to regional and global markets, but due to data availability it only concentrates on the latter. A detailed analysis of regional exports would have been useful because often they are more significant for African SMEs. Apart from greater proximity, exports to neighbouring countries have the advantage of being less demanding in terms of quality, speed of response and volume. They constitute, therefore, for many SMEs an appropriate terrain in which to “learn by exporting”. The discussion on SME policy and support services in this report does not, however, distinguish between different export destinations because differences in relevance exist in degree and not in principle.

12. A good understanding of both general macro-economic trends and firm-level analysis is required to provide realistic policy recommendations for helping SMEs to compete in regional and global markets. This section deals with the former, presenting a brief analysis of factors that have shaped the economic performance of African companies over the last decade. It uses macro-economic indicators to compare the current state of the region’s industrial development to that of other developing regions (i.e. Latin America, South Asia, East Asia, and Middle East and Northern Africa). It

tries to explain Africa's relatively weak export performance with reference to the main determinants of industrial development, in particular human resource development and technological effort. This overview sets the scene for SME development in Africa, which is the focus in the remainder of the report.

13. This section draws mainly on very recent research on export competitiveness, patterns of industrial success and governments' strategies (Lall 2000; Lall, Albaladejo, and Aldaz-Carroll 2000), and uses data from different sources: UN Comtrade for exports, UNESCO's Statistical Yearbook 1997 for human resources and R&D expenditure, and UNCTAD's World Investment Report 1997 for inward FDI. While based on these sources, some of the data result from calculations carried out specifically for this report.

B. Export performance

14. This report is concerned with measures to help SMEs to compete in regional and global markets. The purpose of this section is to review briefly recent African export performance. In a liberalising world, export success is a good indicator of industrial competitiveness. It reflects countries' ability to compete internationally as the main means to earn foreign exchange (especially when domestic markets are small), reaping economies of scale, and accessing new technologies. Export performance indicates the efficiency of the industrial sector in facing more direct and intense competition because of trade liberalisation and falling transport costs.

15. It is increasingly recognised that technology plays a significant role in the trade patterns not only of developed countries but also of developing countries (see Fagerber 1996, and Lall 2000). Lall (2000) classifies exports by technological content. Within manufactured exports, he distinguishes between resource-based (RB) and low-technology (LT) products, which are considered "easy technologies", with the main drivers of competitiveness being natural resources and low wages, and medium-technology (MT) and high technology (HT) products, which are considered "complex technologies" and require higher skills and intense technological activity¹. A country's export specialisation in one category or other can reflect its ability to compete internationally on a sustainable basis. For instance, competitive pressures have especially been felt in countries with a comparative advantage in labour-intensive and low-value-added sectors where barriers to entry are low and industrial rents easier to access. This appears to be the case of most countries in Sub-Saharan Africa. On the other hand, countries specialised in knowledge-driven exports (i.e. MT and HT products) base their competitiveness on higher and more sustainable innovation rents, with technological frontiers difficult for newcomers to reach. At the firm level, this strategy requires technological effort and investment in human capital.

16. A region's relative export specialisation shows up in its "revealed comparative advantage" (RCA). Table 1 gives the RCAs (including primary products) for the main regions in the developing world².

¹ For the full technological classification of exports, see Lall, Albaladejo and Aldaz-Carroll (2000).

² RCA as computed here is defined as a country's market share in a specific technological category deflated by the country's world market share in total manufactured exports.

Table 1: Regional RCAs of LDCs in 1998 by technological categories

	Primary	Resource-based	Low-Tech	Medium-Tech	High-tech
East Asia	0.643	0.742	1.601	0.644	1.524
South Asia	1.453	1.216	3.18	0.301	0.178
MENA	4.973	1.242	0.869	0.234	0.063
Latin America	2.305	1.232	0.806	0.799	0.647
SSA	3.028	1.786	0.806	0.446	0.151
SSA1	5.25	1.365	0.855	0.136	0.04

Source: calculated from UN Comtrade, RCAs computed by Albaladejo (2000).

Note: MENA stands for Middle East (including Turkey but excluding Israel) and North Africa; SSA stands for Sub-Saharan Africa (including South Africa); SSA1 excludes South Africa.

17. As can be seen, Africa's comparative advantage in exports, excluding South Africa (SSA1), lies mainly in industries requiring simple technologies, that is, primary and RB products. This is not a good sign of industrial dynamism since the technology-intensity of exports is clearly a powerful force for their growth. Taking the period between 1985 and 1998, global manufactured exports grew nearly three times faster than primary exports; and within manufactured exports, RB grew the slowest, LT and MT at the same pace and HT the fastest (Lall, 2000). Among LDCs, East Asia and Latin America are the regions best positioned in the manufactured export scene as they have a relative comparative advantage in the more dynamic and technologically advanced industrial sectors. In Africa, one should acknowledge the relatively good performance of some countries, namely Morocco, Tunisia, and Mauritius, with RCAs above the regional average in the textile industry.

18. Table 2 gives each region's share of developing world's exports by technological category. It shows that exports are highly concentrated, with East Asia dominating all categories, including those sectors (RB and LT) where the region does not have a relative comparative advantage. Latin America follows at a distance.

Table 2: Regional shares of LDCs' manufactured exports in 1998 by technological categories

	All manufactures	Resource-based	Low-Tech	Medium-Tech	High-tech
East Asia	69.0	47.5	70.2	63.8	85.5
South Asia	3.8	4.7	8.5	1.8	0.6
MENA	6.1	15.0	7.2	4.4	0.7
Latin America	19.3	28.0	12.6	28.1	12.9
SSA	1.8	4.8	1.5	1.9	0.4
SSA1	0.8	1.4	0.2	0.2	0.0

Source: calculated from UN Comtrade

19. Although Sub-Saharan Africa’s manufactured export strength is in RB products, its share in developing world exports is small, and only comparable to that of South Asia. Moreover, without South Africa (SSA1), Africa’s share is tiny in all technological categories, including RB products.

C. Human resources

20. It is widely acknowledged that the development of countries’ industrial capabilities requires investments in human capital. With the growing pace of technological change, the spread of information technologies and intensifying competitive pressures, the need for specific skills has become even more demanding. While general industrial development in the past required simply improving the basic educational system and encouraging in-firm training, the emerging competitive setting calls for greater emphasis on high-level, specialised training to meet industry’s needs.

21. Enrolment data are often used to measure countries’ human capital base. However, it is very difficult to assess skills formation on a national basis simply because enrolment data tend to ignore the qualitative differences in the education provided as well as the fact that learning also occurs in companies. Nevertheless, they are the only data available on a comparative basis and are indicative of the national base for skills acquisition. Table 3 shows the total number of students in tertiary education and their share of the total population in each region.

Table 3: Tertiary level enrolment by regions (1995)

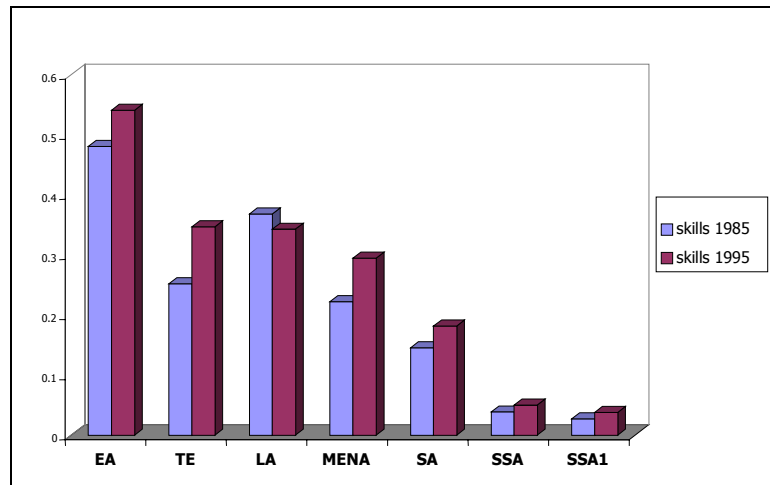
	3 Level Enrolment	
	No. students	% population
East Asia	8,579,300	2.80%
Transition Economies	2,025,800	1.95%
Latin America	7,677,800	1.64%
MENA	4,571,900	1.26%
South Asia	6,545,800	0.54%
Sub-Saharan Africa	1,542,700	0.28%
Developing Countries	35,345,800	0.82%

Source: calculated from UNESCO (1997)

22. The proportion of East Asia’s population enrolled in tertiary education is 10 times as high as that of Sub-Saharan Africa (including South Africa), more than twice as high as that of the Middle East and North Africa, and five times that of South Asia. Note that the average for all developing countries is over 3 times that of Sub-Saharan Africa.

23. Given this report’s interest in high-level specialised training, Figure 1 shows enrolment at the tertiary level in technical subjects (i.e. science, mathematics and computing, and engineering) between 1985 and 1995.

Figure 1: Technical tertiary enrolment by regions (% population)



Source: calculated from UNESCO (1997)

24. East Asia enrolled almost 0.6% of its population in technical subjects at the tertiary level in 1995, while enrolment in other regions did not reach 0.4 % of their total population. During the period 1985-1995, tertiary technical enrolment grew substantially in Transition Economies (0.09%), in Middle East and Northern African countries (0.07%), and East Asian countries (0.06%)³. It is worth noting here the relatively “healthy” national skills base of some Northern African countries, namely Morocco and Tunisia (with 0.25 and 0.24 % of the population matriculated in technical subjects at university level). In contrast, Sub-Saharan Africa had only 0.05 % of its population enrolled in technical subjects in 1995, and only experienced a tiny positive change (0.01%) between 1985 and 1995. Again, South Africa is the exception, with 0.17 % of its population enrolled in technical subjects. Zimbabwe is also above the region’s average but still far from neighbouring South Africa and Northern African countries.

D. Technological effort

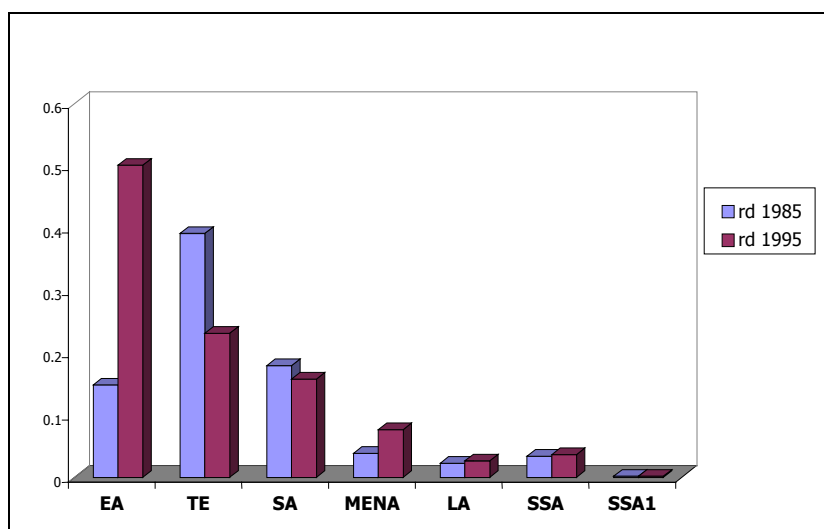
25. Technological effort in LDCs consists less of R&D than of diffuse engineering and technical work for learning, adaptation and improvement. Although it is difficult to measure, its intensity and effectiveness is a key determinant of industrial competitiveness. Formal R&D is a rough indicator of technological effort, and data can be obtained for many countries, including many in Africa. In the context of developing countries, R&D becomes necessary to absorb technologies and adapt them to local conditions. A strong R&D base permits better and faster technology diffusion, facilitates greater and more efficient use of local resources, permits the industrial sector

³ These are not annual growth rates. It is the percentage in 1995 minus the percentage in 1985.

greater flexibility and diversification, and makes local economies more attractive to TNCs.

26. R&D expenditure in productive enterprises is perhaps the best indicator of *technologically useful* R&D. Figure 2 shows the regional averages of R&D financed by productive enterprises as a percentage of GNP in 1985 and 1995.

Figure 2: Regional R&D financed by productive enterprises (% of GNP)



Source: calculated from UNESCO (1997)

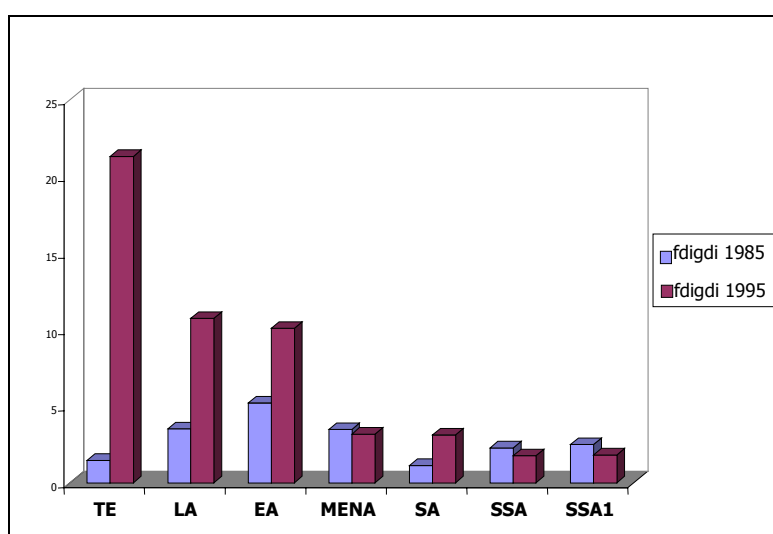
27. Productive-enterprise-financed R&D in East Asia is nearly 250 times higher than in Sub-Saharan Africa (excluding South Africa), 25 times higher than in Latin America, 7 times higher than in Middle East and Northern African countries, and over 2 times higher than in Transition Economies. Positive increases in enterprise R&D in 1985-1995 have been experienced mainly by East Asia (an impressive 0.36% increase) and MENA (a 0.04% increase). It is worth noting that Tunisian enterprises' productive R&D spending (0.24% of GNP) is the highest in Northern Africa, and higher than that of Poland, Turkey, Brazil and Malaysia. As can be seen, Sub-Saharan Africa's R&D expenditure is nearly non-existent, and this pattern did not improve in 1985-1995. The exceptions are South Africa, with productive-enterprise-financed R&D accounting for 0.38 % of GNP, and Mauritius which, although the spending is still comparatively low, is showing signs of in-firm R&D activity.

E. Inward FDI

28. While this report is mainly concerned with African SMEs, a brief review of foreign direct investment (FDI) is useful because industrial competitiveness is increasingly related to TNC activity. TNCs now account for over two-thirds of world trade, and their market share is continuously rising in response to liberalised trade and investment policies (UNCTAD 1997). Increasing FDI flows in the Third World have opened up a range of alternatives for companies in developing countries to participate in the global economy. Increasingly, Northern TNCs seek to decentralise labour-intensive

stages in the production process to LDCs, taking advantage of their abundant and cheap workforce, while keeping the innovation and research sites in their home countries. Although many question the benefits of an FDI-dependent strategy, it is clear that this new international division of labour is helping some companies in LDCs to export, considering their weak internal capabilities. This strategy does not necessarily mean a neglect of skills upgrading and domestic technological activity. Figure 3 shows the regional averages for inward FDI flows as a percentage of gross domestic investment in 1985 and 1995.

Figure 3: Regional inward FDI flows (% of GDI)



Source: calculated from UNCTAD (1997)

29. The figure illustrates the differences in the contribution to relative industrial development made by TNCs. At one end of the scale, Transition economies, Latin America and East Asia have drawn heavily upon FDI in recent years, with countries like Hungary, Malaysia, Mexico, Poland and Singapore being highly dependent on FDI (more than 15 % of GDI). At the other end of the scale, TNC presence is relatively small in MENA, South Asia, and Sub-Saharan Africa, and in the case of the first and third the trend was negative between 1985 and 1995. Exceptions in Northern Africa are Egypt (7.2%), Morocco (4.1%), and Tunisia (6.1%). It is important to note that FDI in Sub-Saharan Africa has targeted mainly oil economies, for instance Nigeria (50%).

30. What explains the relatively low FDI inflows in Sub-Saharan Africa? There is a range of reasons why TNCs stay away from particular countries, such as, for example, poor infrastructure or shortage of skilled manpower. Particularly important factors are political instability and macro-economic turbulence (e.g. a widely fluctuating exchange rate and an inflationary economy). These two factors seem to weigh against investment in Africa. The PRS group publishes the *'International Country Risk Guide'*, which compiles monthly data on political, financial and economic risk factors. The overall composite risk ratings for regions are shown in Table 4.

Table 4: Composite Risk Ratings 1998

	Regional Average
Latin America	66.8
East Asia	71.1
Transition Economies	71.0
MENA	68.1
South Asia	62.7
Sub-Saharan Africa	61.5

Source: ICRG taken from WDI2000, computed by Albaladejo 2000

Important note: A higher score indicates less risk

31. According to this table, Sub-Saharan Africa presented the highest probability of political turmoil and economic and financial risk among all developing regions in 1998. The average for South Asia is also low, denoting here again high levels of economic and political risk, which may have contributed to the region's low ability to attract foreign investment. The ratings for political turmoil and economic risk were more favourable for some Sub-Saharan and Northern-African economies such as Egypt, Mauritius, Morocco, South Africa and Tunisia.

Conclusion

32. This section emphasised the changing nature of global competition and analysed Africa's industrial performance and capabilities vis-à-vis those of other developing regions. The analysis shows the relatively poor performance of the region as a whole: Africa's comparative advantage lies in processing primary products and labour-intensive sectors, yet the region only accounts for a tiny share of developing countries' total industrial exports. Particular attention was paid to its weak base for skills formation and the limited R&D expenditure by productive enterprises.

33. Nevertheless, there have been exceptions. A country-level analysis shows that Africa comprises the world's poorest economies and some promising ones. South Africa has a human resource base as strong as that of Brazil and stronger than that of Egypt, Hungary or Malaysia, and its productive-enterprise-financed R&D exceeds that of New Zealand and Spain. Morocco and Tunisia show very promising signs in their industrial strategies. Both have combined TNC activity with investment in human skills formation (exceeding Hungary, Indonesia and Malaysia in tertiary technical enrolment) and encouraging in-firm R&D operations (especially in the case of Tunisia). Mauritius exhibits an enterprise R&D similar to that of Thailand and not far from Mexico's.

34. The purpose of this section was to provide the macro context in which SMEs operate in Africa. For an in-depth analysis of SME development, a framework is needed which captures the micro determinants at firm level (both external and internal to the firm). The next section presents such a framework.

III. Analytical Framework for Analysing and Fostering SME Development in Africa

35. Understanding SMEs' behaviour is not an easy task. Their economic performance can be hampered or fostered by many different factors. Some are internal to the enterprises, while others belong to the economic and social environment in which they operate. Some are generic to all SMEs while others are sector specific. Some factors seem to have a more immediate impact on enterprise output, while others have time lags. Some can be directly targeted through government intervention, while others are more effectively promoted through market channels.

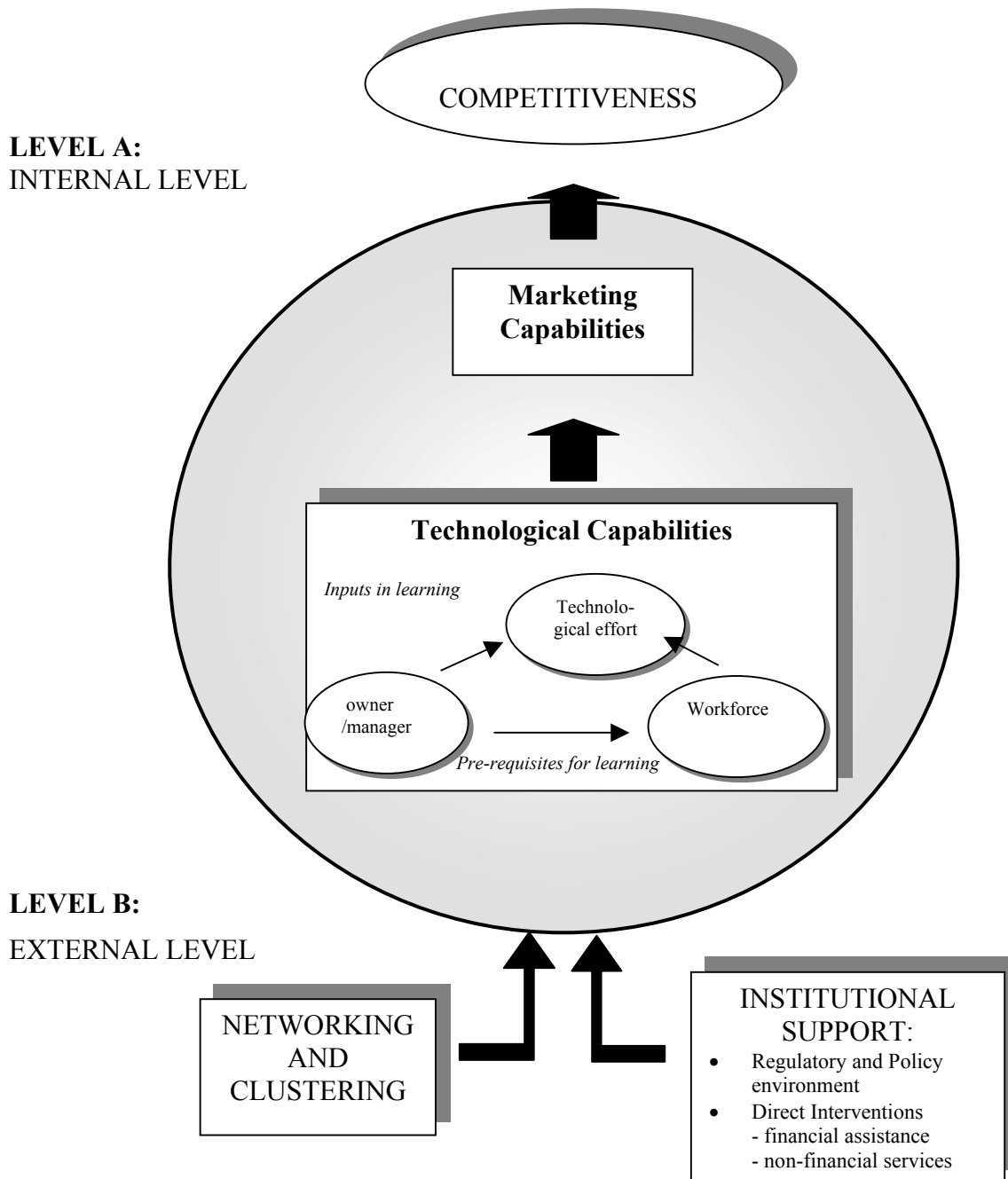
36. This report cannot fully capture all these dimensions, but it puts forward a strategic framework depicting the main elements, levels of analysis and links that are important for SME development in Africa. Since the report is particularly concerned with support services for improving technological and marketing capabilities in African SMEs, one needs to open the "black box" in order to understand the sort of requisites and internal processes that lead to technological upgrading and building of marketing capability in firms. The internal elements and their links with external factors are captured in Figure 4.

Internal Factors

37. The framework distinguishes between factors that are internal and external to the enterprises. The large circle in the centre of the diagram captures the key internal requisites and processes that might lead to increased output and innovation in enterprises. These inputs are often called "technological capabilities", and they are defined as the knowledge, skills and efforts required for firms to bring about an indigenous process of technological development. This can occur by increasing efficiency in production activities (production capabilities), for instance through quality controls, production scheduling and preventive maintenance. A more advanced technological development is making major improvements to established technologies, or creating new ones (innovation capabilities).

38. Such capability acquisition cannot be taken for granted. It often requires purposeful and cumulative efforts aimed at assimilating and modifying existing technologies, adapting them to local conditions. This is especially the case in developing countries since major innovations are still concentrated in technologically advanced countries. The effectiveness of these integral efforts that lead to in-firm technological learning is assumed to depend on two main factors. First, the educational background and prior working experience of the founder/manager; and second, the skills and working conditions (including remuneration levels, job security, etc.) of the workforce, with the former affecting the latter.

Figure 4. Framework to support SME development



Source: adapted from Albaladejo and Romijn (2000)

39. Indeed, research carried out in Tanzania, Uganda and Zimbabwe (Trulsson, 1999) shows that the most technologically advanced, productive and competitive SMEs are those run by well-educated entrepreneurs (at least with A-levels). They came from families where there was a prior record of entrepreneurial activity, and had been employed before venturing into their own business. International exposure was also an important factor: many entrepreneurs had spent more than six months abroad, either studying or working for foreign companies. Entrepreneurs of well-performing companies in these three African countries acknowledged the importance of creating good jobs for skilled people. They paid higher salaries and spent more resources on training than the other companies. Labour turnover was lower. This study clearly shows the positive link between internal technological capabilities and increased productivity and innovation, as shown in our analytical framework.

40. Marketing capabilities are required to make the product available and attractive to the buyer. They include activities concerned with establishing a marketing channel from the factory to the buyer (direct sales or intermediaries), organising the logistics (related to mode and speed of transport), promotion (advertising, branding) and after-sales service. These activities have received less attention from researchers and policymakers than those concerned with improving products and production processes. The neglect of marketing has, however, begun to be rectified (Lall 1991, Humphrey & Schmitz 2000). There is now a clear recognition that breaking into distant markets, especially export markets, is a discontinuous step. This is most clearly expressed by Roberts and Tybout (1995), who suggest that the critical barriers to entering export markets are the high cost of gathering information on foreign markets, establishing marketing channels and defining products suitable for the new market.

External Factors

41. The importance of building up internal technological and marketing capabilities to compete with more original, fashionable and quality products is widely acknowledged. Building up those capabilities requires efforts and investment within firms. However, this is a very costly and risky process especially when SMEs are left on their own. This situation is even tougher in developing countries, where the regulatory and policy environment often constrains SMEs in attracting the capital required for subsequent technological learning.

42. Research has shown that capability building and competitiveness also depend on factors external to the firm. As shown in Figure 4, this external context is given first by the type of network or cluster to which the firms belong. It is now well recognised that the 'lonely' enterprise is doomed and the quality of relationships with other producers, suppliers and customers is critical for learning and competing, as expressed in the term 'collective efficiency' (Schmitz 1995).

a. Groupings

43. Both sets of external factors require more explanation. Industrial clusters do not constitute a focus of this report but require some discussion because the recent international literature on SMEs has emphasised the relevance of clustering for overcoming growth constraints and reaching distant markets.

44. Clustering facilitates the mobilisation of financial and human resources. It breaks down investment into small riskable steps: the enterprise of one creates a foothold for the other; ladders are constructed which enable small enterprises to climb up and grow. It is a process in which enterprises create for each other - often unwillingly, sometimes intentionally - possibilities for accumulating capital and skills. Probably the best example is the Taiwanese computer industry that gave rise to global players but started as a cluster of small firms pursuing what Levy and Kuo (1991) call the 'bootstrap strategy'.

45. While clustering facilitates this strategy, such evolutionary growth does not necessarily follow. McCormick's (1998) review of African clusters shows that the accumulation of capital and skills remains low. Contrasting this work on African clusters (carried out at IDS Nairobi) with the work of Weijland (1994, 1999) on incipient clusters in Indonesia brings out clearly the fact that collective efficiency (gains from clustering) only emerges under the following conditions:

- ***The existence of trade networks.*** Clusters that are limited to local markets are likely to experience involutionary rather than evolutionary growth. Clustering tends to attract traders but one cannot simply assume that effective trade links to larger (usually distant) markets exist. For example, Weijland's contribution shows that trade networks in Indonesia are highly developed but not ubiquitous. In an important earlier paper she shows that rural clusters which are well connected to distant markets by traders have higher incomes than those which are not (Weijland, 1994). In a similar vein, Pedersen (1997) has stressed that the poor distribution networks in East and Southern Africa are a major factor in accounting for the inferior growth performance of small producers.
- ***The existence of effective sanctions and trust.*** Sanctions and trust are important within clusters and their trading connections (Humphrey and Schmitz, 1998; Knorringa, 1996; Mead, 1984; Nadvi, 1999). Where sanctions and trust are missing, a production system requiring deepening specialisation and interdependence of formally independent firms is unlikely to develop. McCormick (1998) stresses that contract enforcement and economic co-operation are often hampered by institutional failures and that this explains in part the dearth of successful clusters in East Africa. One of the rare African success stories – Nnewi in Eastern Nigeria – supports this emphasis on institutional factors (Oyelaran-Oyeyinka, 1997). According to Brautigam (1997), the socio-cultural networks of Nnewi's entrepreneurs reduced transaction costs, enhanced trust and were, thus, critical to the cluster's success. Lack of trust also brings discontinuities in the learning process. Knorringa (1996) has shown most clearly how distrust between producers and traders, due to existing socio-cultural barriers, can hamper the process of local learning and retard a cluster's technological development. Similarly, socio-cultural divides between Asian and African business communities seem to explain the lack of upgrading in the Kenyan fish cluster studied by Mitullah (1999). This experience appears to have wider significance, explaining – to some extent – why many East African clusters remain rudimentary and, more generally, why there is a missing middle in much of African industry (Ferrand, 1997).

46. In summary, clusters and networks constitute the immediate external context in which SMEs operate. The benefits of clustering are widely acknowledged: the spatial and sectoral concentration of firms generates externalities, favours inter-firm co-operation and constitutes a niche for effective policy support. Clustering can be particularly significant in poor countries because it facilitates growth in small and riskable steps. Small amounts of capital, skills and entrepreneurial talent can be made to count. It was emphasised, however, that clusters only experience industrial growth where effective trade networks connect them to sizeable markets and where trust sustains inter-firm relations. Research shows that although clusters are contributing to the industrialisation process in Africa, the experience is diverse (McCormick, 1999). On the one hand, cases such as Ghana's metalwork cluster in Suame and South Africa's clothing cluster in Western Cape have generated positive externalities for SMEs, namely access to markets, labour market pooling and significant technological spillovers. On the other hand, cases such as Nairobi's garment cluster in Eastlands and metalworking cluster in Kamukunji present very weak linkages and few technological spillovers.

b. Institutional support

47. The second set of external factors concerns institutional support. This is the determinant with which this report is primarily concerned. It includes the regulatory and policy environment provided by the state and the range of support services provided by public agencies and/or private organisations. The diagram helps to put institutional support in its place. Policies and support services are just one set of factors that determine the competitiveness of enterprises. This is worth keeping in mind because the role of government policy and support services is often exaggerated. As far as *institutional support* is concerned, SMEs can benefit from two types of support (see Figure 4). On the one hand, there is the government's role in creating an enabling regulatory and policy environment. On the other, there is direct support through private and public agencies that provide financial assistance and technical services to SMEs.

48. It is generally accepted that the government's most important task is to provide an enabling *regulatory and policy framework*. Such a framework should contain:

- A stable fiscal and monetary policy setting with reasonable interest rates, a system of financial markets that provides incentives to save, and mechanisms to channel savings into investments. For instance, a lower tax rate on initial profits allows firms to retain some earnings and to increase investment as appropriate.
- Policies that minimise the cost of business licensing and registering while safeguarding public interests.
- Policies that facilitate business transactions such as infrastructure development.

49. An appropriate *political or consensual environment* requires a government's mediating role in involving the main interest groups in the process of industrial restructuring to discuss problems, to reach commonly agreed action plans and to implement policy recommendations. An inter-institution networking approach creates an atmosphere of trust among the interest groups (including SME representatives).

50. Often, obsolete and unfair commercial laws have increased transaction costs for SMEs (more than for larger firms), thereby hampering their economic performance and competitiveness. However, in countries such as Mauritius and South Africa the legal system appears to be more developed and conducive to SME development.

51. Completing the explanation of Figure 4, the determinants of SME competitiveness also include direct intervention, which is usually subdivided into (a) financial assistance, and (b) non-financial services.

52. Financing constraints limit the investment capacity of SMEs and thus hamper their growth. *Financial SME support* mainly refers to subsidies, credits and soft loan guarantee schemes provided by commercial and development banks. NGO credit has increased in the past years given the fact that SMEs in developing countries do not seem to have benefited from bank lending. In general terms it appears that lending to SMEs is seen as a high-risk business since most of these enterprises lack collateral. The problem does not appear to be a lack of funds but rather how to make them accessible to SMEs. Available funds are often diverted to the larger enterprises and only an insignificant number of SMEs seem able to attract bank financing (UN, 1993).

53. Many development agencies seek to boost the technological capabilities and competitiveness of SMEs through *non-financial services*. Broadly speaking, they cover two areas:

- Services concerned with improving production and innovation capabilities, such as counselling on production lay-outs, quality standards and maintenance; providing information for technology development, launching co-operative joint operation of large-scale and expensive equipment; testing of raw materials; and training of entrepreneurs and workers.
- Services concerned with developing commercial/marketing activities in firms, such as marketing training, information gathering, business linkages and co-operative sales initiatives.

54. Who provides these services? They can be delivered through public service centres or through the business environment (commercial channels). Most service providers charge a price or a performance-based commission. Although they often provide services tailored to the needs of their clients, their affordability by the poorest businesses is still questionable. In recent times, services provided by and channelled through private enterprises have attracted the attention of donor agencies, though the role of the latter is controversial as they can generate market distortions. (A fuller discussion of best practice in non-financial support services will be provided in Section 3.4.)

55. To sum up, this section has presented an analytical framework depicting the main elements affecting enterprise performance. Although internal efforts often lead to increased output, they are seen as uncertain, costly and risky processes, which SMEs cannot always afford. In the SME spectrum, external elements can therefore play a major role. On the one hand, clustering and networking have helped enterprises in reaping economies of scale through collective efficiency. On the other hand, institutional support can provide a conducive environment in which business can flourish. General support comprises policies affecting businesses regardless of size while SME support includes specific policies concerned with the main bottlenecks faced by SMEs.

IV. The Regulatory and Policy Environment

56. The sections which follow discuss in more detail the institutional support for SME development in Africa. They cover four areas: the regulatory and policy environment (Section 4), infrastructure (Section 5), access to finance (Section 6), and non-financial support services in technology and marketing (Section 7). Each section summarises lessons from international experience, provides an overview of strengths and weaknesses in 13 African countries, and gives examples of good and bad practice in these countries. This empirical assessment relies heavily on the 13 mission reports produced by ECA officials and local consultants.

A. International lessons

57. In discussing the requirements for a favourable policy environment, it helps to distinguish between requirements relevant to all enterprises (irrespective of size) and those which are particularly important for SMEs. It is agreed that there are two elements which help all enterprises: first, a stable macroeconomic environment characterised by tight inflation control, low budget deficits, and competitive real exchange rates. Second, an outward-oriented, market-friendly trade and industrial regime which reduces import controls and tariffs. The reduction in import restrictions and tariffs needs to be gradual, however, so that local firms have time to adjust to the new challenges and government has time to design support services which help firms to compete with imports or assist them to enter the markets of neighbouring or even distant countries.

58. Current SME-specific problems in the regulatory and policy environment are a product of past industrial strategies. As shown by Späth (1992), these strategies have four features which work against SMEs and which need changing. The first feature is the bias in overall incentive policy. Many developing countries pursued a strategy of accelerated industrialisation based on large-scale enterprises. Through investment incentives, credit policies, trade regulations, foreign exchange allocations and licensing, economic policy favoured the establishment and growth of large firms and, often inadvertently, discriminated against SMEs, hampering competition and innovation.

59. The second problem is centralised administration. Regulations and policies have to be implemented by administrative institutions and authorities. In many developing countries, bureaucracy has displayed a high degree of centralisation of resources and decision-making. Initiatives by local authorities to promote SME activities are often stifled by a centralised decision-making process and lack of financial resources at the local level.

60. The third problem is red tape. Procedures to comply with regulations such as registration, taxation, health and environmental regulations and procedures necessary to benefit from government incentives are difficult to comply with partly because of bureaucratic requirements. While large firms have staff specialised in these matters, such requirements represent an enormous burden for SMEs. The required change is, therefore, not exemption for SMEs or complete de-regulation but simplification of procedures.

61. The fourth problem can be called ‘institutional growth traps’. In order to overcome the negative effects of broader policies on small producers, some countries have introduced special incentives and regulations for SMEs, such as exemption from taxes and labour laws. These well-intentioned policies can be a mixed blessing in that they limit the expansion efforts of small firms or lead to multiple small establishments instead of a focus on innovation and marketing.

B. Regulatory environment in Africa: strengths and weaknesses

62. As mentioned earlier, the regulatory and policy environment is a key factor in SME competitiveness. Table 5 provides a summary of the current state of the regulatory environment in 13 African countries. Its objective is to provide an overview for Africa. It indicates whether the policy environment is enabling or disabling and whether changes (positive or negative) have occurred recently.

63. In general terms, regulatory and policy environments vary across Africa. In countries such as Cameroon, Ethiopia, Gabon, Nigeria, Senegal and Uganda, evidence from the mission reports shows that the environment in which SMEs operate proves to be a major handicap for their expansion and growth. In Cote d’Ivoire, Kenya, Morocco, Namibia and South Africa, SMEs seem to have benefited from recent improvements in regulatory policies, though many conducive policies have not been implemented yet, and the general environment remains disabling for SME development. Countries such as Mauritius and South Africa have been able to shape regulatory policies not only to benefit local SMEs, but also to attract foreign investors. These efforts should be considered “best practice” for other African countries, bearing in mind the region’s relatively poor performance in fostering indigenous SMEs and attracting foreign companies.

Table 5: The regulatory environment in African countries: current state and recent changes

	Current State			Changes		
	Enabling	Variable	Disabling	Improved	Same	Deteriorated
Cameroon			✓		✓	
Côte d’Ivoire		✓		✓		
Ethiopia			✓		✓	
Gabon			✓		✓	
Kenya		✓		✓		
Mauritius	✓			✓		
Morocco		✓		✓		
Namibia		✓		✓		
Nigeria			✓		✓	
Senegal			✓	✓		
South Africa		✓		✓		
Tunisia	✓			✓		
Uganda			✓		✓	

C. Examples of good and bad practice in Africa

64. Many African countries do not have a legal and regulatory framework that supports the growth of the SME sector. In the case of Uganda, an extensive number of outdated and cumbersome laws and regulations have increased the transaction costs of SMEs, thereby hampering their economic performance and growth. In Ethiopia, the complexity of the customs system and the many forms and declarations required have had a negative impact on the general business climate, diverting entrepreneurs' efforts from more productive tasks. Evidence shows that customs duties and tariffs discriminate against local producers. For instance, the tax levied for imported raw materials is often higher than the tax on the imported finished product that uses the same raw materials. This substantially increases the production cost of companies that require highly taxed imported inputs, therefore limiting their competitiveness.

65. In other African countries, the problem has often been the government's inconsistency and lack of transparency in implementing policies. Take the case of Nigeria, for example. In recognition of the key role played by SMEs, the government formulated special policy measures and programmes to encourage their development. It included favourable laws and regulations on contracts, leasing, and corporate tax, as well as fiscal and export incentives for SMEs. However, the political will for proper implementation was never there. Corruption diverted the support programmes from the original beneficiaries. Illegal permits and licenses were given at all levels to family members and friends operating informal micro-enterprises that did not qualify for tax relief and other incentives. Consequently, there was little or no impact on the original target group.

66. In Senegal, entrepreneurs complained about the complex administrative procedures for trade transactions and the lack of transparency in the processing of administrative matters. However, the government is trying to overcome these obstacles through the promotion of Trade Point Senegal (Box 1). This and all subsequent boxes are taken from the ECA mission reports mentioned in the Introduction.

Box 1: Trade Point Senegal

From its inception, **Trade Point Sénégal** set out to put the country on course towards the global trade arena by means of a telematic infrastructure which would promote external trade and help install an export-push strategy. To fulfil its mission and achieve its aims, **Trade Point Sénégal** embarked on the establishment of the following instruments in February 1996:

- An external-trade facilitation system that relies on new information and communication technology to simplify processes and reduce costs. The system is also intended to ensure the adaptability of information to statistical and trade applications.
- A reliable trade information system, providing easy access to relevant country-level and international information, as well as information exchanges and transactions among in-country and international economic operators, through the Global Trade Point Network (GTPNet).
- The infrastructure of **Trade Point Sénégal**, its export promotion mechanisms, and its approach to interconnectivity management are an innovative factor in the global trade environment. That conceptual framework is extendable to new information and communication technology in the domain of the various applications made possible by the rapid development of digitised networks, such as electronic commerce and teleservices.

The partners, Government and private-sector entities are involved at all stages of the project, in collaboration with Trade Point experts; accordingly, they have been called upon to authenticate models, prototypes, the internal pilot site and the external pilot site, all of which are key phases of the project. Throughout, this steady interaction is integrated into a broad-based steering committee and subsequently into user groups (**groupes des utilisateurs**, or "GU", as they are commonly known). The purpose of the user groups is to provide the necessary backup throughout the implementation process. This involves, *inter alia*, defining needs and expectations, authenticating structures and interfaces, validating prototypes and models, technical tests, training in the use of the system, and so on.

67. Implementing an appropriate regulatory and policy environment in which business can flourish is a long and costly process that requires the commitment of the different parties involved. Some African countries such as Cote d'Ivoire, Kenya, Morocco, Namibia and South Africa improved it substantially the environment of SMEs over the years.

68. SMEs in South Africa are considered important instruments for employment generation, and economic empowerment of formerly disadvantaged groups. However, the legacy of apartheid left black-owned enterprises deprived of many rights and fiscal incentives. The regulatory environment is therefore not very conducive to SME development, at least for the majority of black-owned companies. NTISIKA, the South African Enterprise Promotion Agency, has carried out several studies to improve the situation. Emphasis is being put on targeting those companies owned and controlled by formerly disadvantaged groups. Efforts are being made to reduce entry barriers, to provide tax incentives to encourage start-ups and expand existing businesses, and to reduce the complexity of the formal procedures to register businesses.

69. Morocco's government has made much progress in simplifying legal and accounting procedures for registering companies, though many acknowledge that some are still too complex for the smallest companies.

70. The government of Namibia identified in its policy paper three intervention areas to improve the environment for SME development: de-regulation and incentives, proactive programmes, and institutional support. Emphasis has been placed on solving long delays in processing permits, licenses and approvals by introducing a one-stop facility for the processing of all permits, and setting targets for maximum permissible time for processing applications.

71. Finally, Kenya is a good example of a variable regulatory and policy system that has been improved over the last few years. The mission report shows that, with the help of DFID, Kenya introduced a single business permit, which has drastically reduced the financial and transaction costs of operating a business. Since its implementation, the number of companies being registered and allowed to do business in Kenya has gone up substantially.

72. Mauritius and Tunisia are examples of good practice in providing an appropriate and conducive regulatory environment for SME development. In Mauritius, the manufacturing sector, including the SME sector, has been given numerous incentives, which, by the standards of other African countries, are considered generous. Fiscal incentives for SMEs include a 15% company tax and no customs duty on production equipment. However, EPZ and pioneer status companies are given higher priority in terms of incentives to stimulate growth. New SME policies in Mauritius are trying to extend those incentives to SMEs to help them face new competitive pressures. Some of the measures that are likely to be implemented in the near future include the further reduction of bureaucratic procedures for registering companies, VAT exemption on production equipment, and duty exemption for all raw materials used by SMEs. These incentives will definitely help domestic SMEs to compete.

73. The case of Tunisia is particularly interesting. The Tunisian textile industry comprises 2,000 firms, which employ 50 per cent of the active population in manufacturing, and provide over 50 per cent of export revenues. In order to prepare the industry for increased competition following the WTO agreement, the Tunisian government adopted several measures to support SMEs. They included substantial tax and financial advantages such as payment by the government of the employer's contribution to social security. Formal administrative procedures were centralised in a one-stop shop (the head office of the Agency for the Promotion of Industry) to reduce transaction costs. All administrative steps are now carried out in less than 48 hours. The favourable legal, financial and administrative system has not only benefited Tunisian SMEs, but also contributed to attracting foreign investors.

74. To sum up, poor regulatory environments in Africa are characterised by the absence of laws and regulations for SME development; the complexity of such regulations, which substantially increases the transaction costs of SMEs, putting them at a disadvantage vis-à-vis larger national companies and foreign enterprises; and the lack of transparency in implementing SME support programmes, which deliberately benefit other actors rather than the targeted SMEs. However, a substantial number of African countries have seen major improvements in their regulatory systems over the last few years. They have learnt from successful experiences in Africa and elsewhere that involve the main interest groups in the identification, design and implementation of SME policies.

V. Physical infrastructure

A. International lessons

75. While the economic policy debate has gone through cycles of arguing for and against state intervention, the provision of infrastructure has always been regarded as one of the main tasks of the state. The private sector can participate in making the infrastructure effective, but its regulation is above all a state function. The importance of this function has increased in recent years, because of the changing nature of competition in regional and global markets. Speedy and punctual delivery of manufactured goods has become a major parameter in the new competition. A well-developed infrastructure - for moving goods from factories to ports and for rapid international communication – significantly reduces the transaction costs involved in exporting. Bottlenecks in sea and air cargo space and high charges feed into non-competitive pricing, missed deadlines, poor reputation and cancellation of orders. Long delays in obtaining telephone and electricity connections raise production costs and waste scarce management time.

76. While such problems are universally recognised, the provision of good infrastructure is held back by the enormous investment requirements. In order to secure the funds for such investment, three complementary sources need to be considered. First, the state: given the many demands on state expenditure, it has been suggested that a given percentage of GDP be invested in new infrastructure like roads, ports and airports and in maintaining the quality of existing infrastructure. Second, joint ventures between government and the private sector to develop new infrastructure projects: such arrangements call for some private sector funding and private sector management with government funding and financial guarantees (Wignaraja 1999). Third, foreign aid: much foreign aid has gone into areas where disbursement is difficult and slow. Infrastructure projects, in contrast, can be effective absorbers of large injections. It is important, however, to ensure that the provided infrastructure is not geared primarily towards large, often foreign, enterprises. Given the scarcity of resources and the enormous need for infrastructural improvements in poor countries, a focus on the connectivity of SMEs (in terms of information and material flows) is required.

B. Examples of good and bad practice in Africa

77. In order to foster the economic performance and competitiveness of SMEs, functional, high-quality basic infrastructure is required. An optimal physical and IT infrastructure includes a good, well maintained road network, airport and port, a stable power supply and an extensive telecommunication network. This section provides a summary of the current state of the infrastructure in 13 African countries. Overall it seems that while considerable progress has been made in reforming the regulatory and policy framework, there has been less progress in improving infrastructure. Let us review a few examples of good and bad practice.

Table 6: Infrastructure in 13 African countries: current state and recent changes

	Current State			Changes		
	Enabling	Variable	Disabling	Improved	Same	Deteriorated
Cameroon			✓		✓	
Côte d'Ivoire		✓		✓		
Ethiopia			✓		✓	
Gabon			✓		✓	
Kenya		✓		✓		
Mauritius	✓			✓		
Morocco	✓				✓	
Namibia	✓				n.i.	
Nigeria			✓		✓	
Senegal		✓		✓		
South Africa	✓			✓		
Tunisia	✓				✓	
Uganda			✓	✓		

80. In spite of their huge investments in physical infrastructure, many African countries still have very poor and inadequate facilities for industrial development.

81. Nigeria lacks a good road network in the rural areas for proper and efficient transport of agricultural products. Only about 40 per cent of the country has pipe-borne water, the provision of electricity is inadequate and very limited in rural areas, and telecommunication facilities are almost non-existent.

82. In Ethiopia the main problems are the scarcity and high cost of land for industrial use, the absence or inadequacy of waste disposal services and an inappropriate administration for infrastructure services.

83. In Uganda, the unreliable telecommunication service is the major obstacle for SME development. The road network is also poor and gets worse in rural areas. Similarly, power cuts and power fluxes are very common, affecting the continuity of production processes in companies.

84. In Cameroon as well as Gabon, the roads as well as railway transport that link production centres and markets are in bad condition. Such poor conditions in basic infrastructure facilities hamper industrial development in general and SME competitiveness in particular.

85. However, some African countries such as Mauritius and South Africa have good infrastructure facilities that have provided a conducive environment for productive activities. According to a survey carried out with SMEs, the quality of roads, power, port, water and communication facilities is more than satisfactory. In the area of telecommunications, Mauritius has a highly developed postal, fax and telex service, as well as an extensive telephone network. South Africa's infrastructure is considered the best in Africa. It has sizeable and efficient ports, a good road network and good air links. However, the mission report rightly points out that because of apartheid, the

transport network was almost exclusively designed to connect white cities and areas. The government is now investing in formerly marginal regions in an effort to resolve the previously unequal access to infrastructure facilities.

VI. Access to finance

A. International best practices

86. Credit projects have been the most commonly used method of providing direct assistance to SMEs. The proprietors of SMEs typically perceive capital to be their most serious growth constraint and one of their greatest assistance needs. Much of this perceived need is typically for working rather than fixed capital, but the demand for working capital varies significantly by subsector and even by type of enterprise within subsector groups. The actual need for working capital, however, is often lower than the perceived need for it. Indeed, working capital shortages are often the symptom of some other constraint. For example, a raw-material delivery bottleneck may force enterprises to keep their raw material inventories at unduly high levels. It is important, therefore, for financial institutions to be able to distinguish between true and perceived needs for working capital.

87. Which mechanisms should be used to deliver financial assistance? A wide array of ‘formal’ financial institutions have been used to deliver credit to SMEs. In some instances, new institutions have been created, in others existing ones have been utilised. Formal financial institutions, however, have been a meagre source of finance for small-scale industry and are reluctant to extend their lending to small-scale firms. While this may be partly a result of institutional inertia, it is also due to the belief that the administrative costs and risks of lending to SMEs are significantly higher than those associated with their regular, larger-scale customers.

88. The schemes that have been successful in providing financial assistance to SMEs have tended to supply working as opposed to fixed capital. Long-term lending to small firms for investment in fixed assets (machinery and buildings) has tended to be less successful. Successful lending schemes tend to be based locally, have decentralised decision-making, and screen loan applications on the basis of the character of the entrepreneur and project feasibility, rather than on collateral. The interest rate, however, has to be high enough to cover operating expenses. As these features resemble those of informal credit institutions, it would appear that the closer formal lending institutions can imitate the practices of informal lenders, the greater the likelihood that they will be successful in making loans to small-scale firms.

89. Governments or international donors could encourage formal financial institutions to enhance their lending to small firms by: (a) paying a share of the administrative cost as well as providing loan guarantees while they learn more about lending to such firms; (b) providing technical assistance to financial institutions to enable them to develop lower-cost screening mechanisms; (c) providing loan guarantees using programme designs which have been tested in developing countries.

90. The above are the main lessons which Liedholm and Mead (1987) and Mead and Liedholm (1998) draw from their long experience in studying SME assistance, particularly in Africa. They also stress that new and innovative approaches have recently been developed for the provision of savings and credit facilities for micro-enterprises, demonstrating that it is possible to reach relatively large numbers of very small enterprises with safe places to save or with very small loans. “The more

successful of these savings and credit schemes are at least operationally self-sufficient, can generate borrower repayment rates exceeding 90% and can be of considerable help to this target group of enterprises, especially to those that ... have shown little interest or capacity to grow” (Mead and Liedholm 1998: 71). Indeed, micro-credit programmes have attracted enormous attention from the practitioner and research community (e.g. Otero and Rhyne 1994; Goetz and Gupta 1996; Sinha 1998).

91. While seemingly successful for purposes of direct poverty alleviation, micro-credit programmes are insufficient for the kind of SMEs which are the focus of this report, namely enterprises which seek to expand and sell to distant markets. The latter are caught in a now well-documented dilemma: public development banks have the required developmental orientation but lack outreach while commercial banks have the outreach but lack the developmental policy. Ways of breaking out of this dilemma through credit guarantees and other devices were identified above.⁴

B. Access to finance in the thirteen selected countries

92. In order to operate efficiently, SMEs require easy access to short- and long-term capital. In Africa, the problem seems to be the accessibility of financial institutions rather than the availability of funds. This is the reason why the table below compares degrees of credit availability and accessibility to SMEs (from high to low) in 13 African countries. It also distinguishes between formal lending (often supplied by commercial and development banks) and alternative lending by NGOs. Again, the empirical assessment in this table draws on the mission reports produced by ECA officials and local consultants.

Table 7: Availability and access to loans in 13 African countries

	Commercial and Development Banks						NGO Finance		
	Availability			Accessibility			Availability		
	High	Medium	Low	High	Medium	Low	High	Medium	Low
Cameroon			✓						✓
Côte d'Ivoire			✓						✓
Ethiopia			✓						✓
Gabon			✓						✓
Kenya		✓					✓		
Mauritius		✓			✓				n.i.
Morocco		✓			✓				✓
Namibia		n.i.					✓		n.i.
Nigeria		✓					✓		✓
Senegal			✓				✓		✓
South Africa	✓				✓				n.i.
Tunisia	✓				✓				✓
Uganda			✓			✓	✓		

⁴ For a recent account of innovative financial instruments, see also Levitsky 2000.

93. As can be seen from Table 7, access to finance remains a major problem in the majority of African countries. Development banks seem to have performed particularly poorly and, in West and Central Africa, they have all collapsed. While loans from commercial banks are at least possible in principle, later examples show that the terms of such access are often punitive for SMEs. Overall it seems that the problems remain severe in Cote d'Ivoire, Cameroon, Ethiopia, Gabon, Kenya, Namibia, Nigeria, Senegal and Uganda. In some other countries, namely Mauritius and South Africa, SMEs appear to have better access to finance, but in general terms, none of the African countries seem to have an efficient structure of financial institutions providing short- and long-term capital to SMEs. In this context, alternative means of financing have been developed, especially in those countries where formal lending is weak. Thus, micro-credit schemes have been promoted by NGOs in many African countries. Access to these schemes is relatively high in Kenya and Uganda.

C. Some examples in Africa

94. The mission singles out the following problems related to the financing of SMEs:

- ***Shortage and inadequacy of financial institutions for SME support.*** This is a major obstacle for SME development. For instance, the Senegalese private sector remains handicapped by the fact that most financial institutions are ill equipped to serve the SME sector. Such institutions appear to have serious internal management weaknesses and unqualified staff, which explains the poor quality of the services provided.
- In some countries such as Cameroon and Gabon, the mission noticed that the human resources of the financial institutions are inadequate both in number and quality. Most staff lack experience and motivation. As these institutions are short of internal resources, they cannot recruit skilled manpower, train staff and pay reasonable salaries.
- In Uganda, the poor performance of banks seems to be due to huge non-performing loans, and lack of efficient management. Several banks have been closed down by the Central Bank due to insolvency.
- ***High interest rates, high collateral requirements, and restriction of collateral to specific assets.*** Commercial banks often discriminate against SMEs because they are considered “high risk” clients with little or no resources to provide collateral. For instance, in Gabon and Cameroon, real interest rates on loans can go up to 25 per cent, and although development banks exist, they operate like commercial banks with the same loan conditions. In Uganda, interest rates range between 22 and 27 per cent. In Senegal, business owners complain about the inflexibility of banks in enforcing onerous collateral requirements for any credit they extend.
- In some other countries such as Nigeria, SMEs’ access to working capital in the form of short-term loans and overdraft facilities is highly limited. Banks and other financial institutions have no confidence in SMEs as they are perceived as high-risk ventures with high rate of failure. They establish prohibitive collateral conditions that most SMEs cannot afford.

- ***Lack of an effective co-ordination mechanism to centralise information on possible sources of finance.*** In most cases, there is no umbrella institution providing information on financial sources. Each individual institution generally advertises only the services it provides. This is widely acknowledged in Kenya, where the lack of an information centre and appropriate channels constitutes a major handicap for the collection of relevant information for SME development.
- In Namibia, there are many government agencies, banks and NGOs involved in supporting SMEs, but the country lacks an effective co-ordination mechanism to centralise SME-related information.
- ***Misuse of government sources.*** Financial assistance from government sources can be misused to target certain sectors of society that are not supposed to benefit from such schemes. In Nigeria, it seems that financial support from government sources is usually directed to political loyalists of the government. These loans are often given as rewards for political support.
- ***Concentration of finance sources in urban areas.*** Due to vast distances between major cities and rural settlements, the delivery cost of credit schemes tends to be exorbitant, making them very expensive to implement. This is certainly the case in Namibia where it has been observed that the vast majority of financial support schemes are concentrated in the capital.

95. Bearing in mind all these limitations to SME finance in Africa, one wonders whether micro-finance institutions have been an alternative to commercial and development banks' funding schemes. Countries such as Kenya and Uganda appear to have a good network of NGOs providing short-term funding for SMEs. The mission reports point out that the main pitfall of these schemes is the limited size of the loans, which does not seem to have a big impact on SMEs' technological capability building and competitiveness. Nevertheless, NGO micro-finance programmes are increasingly being used – at least for short-term needs that are rarely served by commercial and development banks.

96. An initiative similar to that planned in Mauritius (see Box 2) was implemented by the government of South Africa. *Khula Enterprise Finance Ltd* was established as the main financial support service to SMEs. Its mission is to ensure improved availability of working capital for SMEs by offering loans, guarantees and seed funds to provide initial capital through intermediaries (banks). However, it should be acknowledged here that although the initiative is highly innovative, some of the banks involved have not lent in the range most needed.

Box 2: Responding to the financial predicament of SMEs in Mauritius

The Government of Mauritius is soon launching a new innovative financial package of assistance to SMEs with support from the European Union and to be administered by SMIDO.

The objectives of this financial support are to: improve access to finance by SMEs by offering more attractive terms and conditions; reduce the financial constraints (charges, collateral security) on borrowings by SMEs and encourage new business start-ups and expansion of existing SMEs by providing equity participation. The package of assistance consists of an interest bonus fund, mutual guarantee fund and equity participation fund.

The **Interest Bonus Fund** allows the SMEs to benefit from lower interest rates through an in-built interest bonus scheme. Under this scheme the SME will enjoy a bonus of 5 points on interest rates charged on loans granted by commercial banks for the acquisition of technology. The bonus of 5 points is given at the repayment stage.

The **Mutual Guarantee Fund** aims at removing the collateral requirement which severely constrains SMEs' expansion and investment opportunities. The Mutual Guarantee Fund will meet 50% of the guarantee requirements for loans extended to SMEs. The other 50% will be borne by the firm and this arrangement is meant to ensure that the firm participates in the risk and meets repayment requirements.

The **Equity Participation Fund** is meant to lessen firms' dependence on loan capital and promote greater participation in firms through the injection of equity capital. Ultimately, this scheme is expected to stimulate the growth of start-ups and improve the prospects for industrial diversification. Under this scheme, government participation will be 49% and it expects to exit from the partnership within seven years, by which time the enterprise is expected to buy the balance of the shares.

Source: Wignaraja and O'Neil, 1999.

97. To conclude, access to finance remains a major problem for SMEs. Most entrepreneurs have to rely entirely on their own savings and money borrowed from friends and relatives. In some African countries, financial institutions are completely absent. In others they are often inefficiently run by unmotivated and unqualified staff. The conditions for SME lending are usually difficult to meet, especially the collateral requirements. Micro-finance schemes launched by NGOs and aid agencies have presented an alternative source of finance. These programmes have been growing in recent years, but the small size of the loans remains insufficient for SMEs' technological capability building and competitiveness. Some African countries, namely South Africa and Mauritius, are investing heavily in establishing friendlier financial policies for the benefit of SMEs. The move towards introducing mutual credit guarantees and equity participation will help companies address the collateral requirement problem and secure capital.

VII. Non-Financial Support Services: Technology, Skills Development and Marketing

A. Experience of support services in Africa

98. Support services in technology, skills and marketing are crucial for SMEs' economic performance and competitiveness. The table below compares the existence and degree of effectiveness (from high to low) of technology- and marketing-related support services in 13 African countries. It also gives the extent of institutional coordination among the supporting agencies. As in previous sections, the assessment provided here relies heavily on the mission reports.

99. In some African countries there does not seem to be an institutional network providing technology-related support services to SMEs. This appears to be the case in Cameroon, Gabon, Morocco and Namibia. In others, such as Ethiopia, Nigeria and Uganda, these institutions exist, but their usefulness is considered to be low. Only a few countries, namely South Africa and Mauritius, have a technology-related support system which contributes effectively to the technological capabilities of SMEs.

a. support services for skills development and technology acquisition

100. Support services for marketing are also required to connect companies' products and services with regional and international markets. In Africa the experience is variable, with some countries having a good and relatively efficient network of institutions providing marketing services (Mauritius, South Africa and Tunisia), whereas some others have none (Cameroon, Gabon and Senegal), or ones that work poorly (Ethiopia, Kenya and Uganda). All in all, it seems that marketing services are more widespread in Africa than technology-related ones, but overall effectiveness tends to be low in both cases.

101. In some countries support services for technology and skills development are quasi absent. Although the governments of Cameroon, Gabon, Morocco and Namibia acknowledge that the introduction of appropriate technology is crucial for the development of the manufacturing sector, they have no centres to assist SMEs in technology acquisition and transfer, as well as product and process development. In these countries, enterprises' access to machinery and equipment is particularly difficult, operatives are not taught operational and safety procedures, there are no technical training institutions, nor standards for locally produced goods. For instance, a recent survey in Namibia notes that in the absence of a standards institute, Namibian companies have to depend on the South Africa Bureau of Standards to obtain their quality certifications. In Morocco, the Centre for the Promotion of Enterprises does not supply technology-related services and only focuses on improving the management and export-marketing expertise of SMEs. Similarly, SME support institutions in Gabon and Cameroon do not provide technology and skills development services to SMEs.

Table 8: Technology and marketing support services in 13 African countries: existence and effectiveness

	Support Services for Technology and Skills					Support Services for Marketing					Institutional Co-ordination		
	Existence		Effectiveness			Existence		Effectiveness			High	Medium	Low
	Yes	No	High	Medium	Low	Yes	No	High	Medium	Low			
Cameroon		✓					✓						✓
Côte d'Ivoire	✓			✓		✓			✓				✓
Ethiopia	✓				✓	✓					✓		✓
Gabon		✓					✓						✓
Kenya	✓			✓		✓					✓		✓
Mauritius	✓		✓			✓		✓			✓		
Morocco		✓				✓					✓		✓
Namibia		✓				✓			✓				✓
Nigeria	✓				✓	✓			✓				✓
Senegal	✓			✓			✓						✓
South Africa	✓		✓			✓		✓			✓		
Tunisia	✓			✓		✓		✓			✓		
Uganda	✓				✓	✓					✓		✓

102. The presence of institutional support does not guarantee its effectiveness. Support schemes can be badly implemented, misdirected, or short in outreach. For instance, in Ethiopia, the government established the Ethiopian Standards Institute to promote standardisation and quality-control activities in the national economy, but there is little evidence that Ethiopian enterprises have actually gained from such an initiative. In spite of the government's commitment to helping SMEs, the Ethiopian Standards Institute does not appear to provide the sort of services needed to fill these gaps. Lack of manpower with appropriate technical skills, low productivity of labour, and lack of technological information remain the most critical technical problems facing SMEs.

103. Uganda is another interesting case. The National Bureau of Standards is responsible for formulating and promoting national standards as well as developing quality-control assurance systems to enhance consumer protection. Other institutions providing technology-related services include the National Council of Science and Technology, the Management Training and Advisory Centre, and the Mbarara University of Science and Technology. The mission report suggests that there are no industry standards and quality control measures in SMEs, and that the technology-related services provided to companies are inadequate.

104. In Nigeria, in spite of multiple efforts by the government and some multilateral agencies in the area of support services for technology and skills development for SMEs, the mission report underlined the weakness of achievements recorded. These efforts were either misdirected, badly implemented or poorly funded. For instance, the Working-For-Yourself Programme (WFY) has proved to be a useful start-up programme but is very weak on the follow-up and survival side.

105. Some support service schemes in Africa have had a positive impact on companies' technological capabilities. This appears to be the case in Kenya where there are a good number of government agencies and NGOs providing services for technology and skills

development. These include MCTS, Kenya Industrial Research Development Institute, KIPO, Approtec and Kenya Industrial Estates Limited. As far as technology acquisition and transfer is concerned, entrepreneurs affirm that the technical services provided have helped them to foster their internal capabilities and therefore their competitiveness. However, the impact of these services on companies' innovation and production capabilities and skills formation is rather limited. In general, information gathering and dissemination is not well developed in the country, and there are no formal mechanisms for the exchange of experiences and best practices in the area of technology.

106. Other countries such as Mauritius and South Africa seem to have more effective support institutions. The former has a sophisticated and well co-ordinated network of institutions providing technology-related services to SMEs. The Mauritius Standards Bureau is responsible for providing expertise on metrology, standards, testing and quality. The Small and Medium Industry Development Organisation (SMIDO) aspires to creating a strong, modern, export-oriented SME sector. Box 2 presents a summary of the technical services provided by this agency. EPZDA provides services to companies to improve their competitiveness. It focuses primarily on export-oriented companies in the textile sector. IVTB complements the activities undertaken by SMIDO and EPZDA, providing training for SMEs, using government funding. Finally, Enterprise Africa is a regional initiative to facilitate and co-ordinate private sector support initiatives in Africa and to enhance indigenous entrepreneurship. Although there is still room for further improvement, Mauritius seems to be an exemplary case of a co-ordinated and effective institutional support system geared towards the technology and skills needs of SMEs.

Box 3: Technical support services provided by SMIDO to Mauritian SMEs

SMIDO provides technical support services through its technical service centre. The centre is equipped with a variety of workshop machinery to undertake various operations to help small enterprises in the repair and maintenance of their production system wherever possible. Other facilities available at the centre include grinding and sharpening tools used in the furniture sector as well as pattern grading and a clicking press for the shoemaking and leather products sector, and technical advice on acquiring and upgrading production systems. A nominal fee is charged for services provided by the centre. It also provides technical training services in repairs and maintenance and the use of various machines.

The Technical Services Centre is based on the concept of common workshop facilities. Its main functions include: providing technical training courses to upgrade the technical skills of SMEs; disseminating new technology; helping in modernising small and medium enterprises (SMEs); manufacturing parts for SMEs; and providing repair and maintenance services.

Short-duration training programmes are given to upgrade the technical skills of entrepreneurs in such areas as workshop organisation and machine operation (lathe, milling, drilling, gear cutting, welding etc.). The centre also disseminates new technology and helps in modernising SMEs by providing advice as to the best technology available for their specific businesses. It also helps SMEs in manufacturing the parts they use and providing repairs and maintenance services. Between June 1997 and 1998, the centre manufactured 225 parts for 130 enterprises

The new SMIDO's EU-financed project which is about to be launched also has a technical support component. It will include (1) a flash diagnosis fully financed by the project and undertaken on a demand-driven basis to identify strengths and weaknesses of firms and promote growth potential; (2) a direct assistance scheme aimed at extending support services to firm-level activities. The support will be fashioned after the World Bank project for enhancing competitiveness in the manufacturing sector, but will be adapted to the specific needs of SMEs. It will be financed under a cost-sharing arrangement and the enterprises are required to assume 50% of the cost to promote technology transfer, productivity enhancement etc. The project also has a component of technical assistance in the formation of SME associations.

Source: Wignaraja and O'Neil, 1999.

107. As far as South Africa is concerned, it is worth noting that it has a well-endowed network of research institutions, universities and technical schools assisting SMEs in human skills formation and technological capability building. The main player in this regard is NTSIKA Enterprise Promotion, which helps companies with access to markets, training, technology, counselling and infrastructure. The projects launched by this agency include management and entrepreneur development, training of trainers, mentorship programmes, sector enhancement training programme, business development services, manufacturing advisory centres and targeted assistance. Unlike in many other countries in Africa, research institutions and universities play an important role in South Africa's industrial development. These institutions did not have any interaction with SMEs, but recently some are becoming involved in supporting them. For example, the University of Natal has a group of policy-oriented researchers who have helped local enterprises to form a benchmarking club (Barnes and Morris, 1999), an example of best practice not just for Africa but for the developing world as a whole.

Box 3 gives the example of the Centre for Industrial and Scientific Research and its initiatives in support of SMEs.

Box 4: Forging linkages between research institutions and SMEs in South Africa

The South Africa Centre for Industrial and Scientific Research (CISR) is the largest community- and industry-directed scientific and technological research, development and implementation organisation in Africa. Its functions are centred in ten major, market-oriented business units, namely building and construction technology, chemicals and biochemical, food science and technology, manufacturing and communication technology, manufacturing and materials technology, mining technology, textile technology, roads and transport technology and water, environment and forestry technology.

Its activities are aimed at: supporting the technological competitiveness of South African Industry in both the formal and informal sectors; providing technological solutions to improve the quality of life of urban and rural communities; and providing scientific and technological support for decision making in the private and public sectors.

Initiatives CISR has launched recently in support of SMEs include:

- The incubator for empowerment and job creation, which helps to develop SMEs' capacity to implement CSIR-developed technologies to empower entrepreneurs from previously disadvantaged communities;
- The Entrepreneurial Support Centre, which was launched in the North West Province to support both prospective and existing SMEs in the areas of technical extension, training, technology demonstration, administration and mentorship services;
- Its partnership with NTISIKA Promotion Enterprise and the National Productivity Institute: launching a pilot programme of manufacturing advisory centres aimed at assisting SME manufacturers to upgrade their performance and competitiveness in both local and international markets.

b. Support services for marketing

108. Among the visited countries, it has been observed that Cameroon, Gabon and Senegal lack such a marketing support network. The mission reports reveal that marketing support services are completely absent. They also show that export-oriented companies in these three countries have to struggle to get the required documents in order to export their products.

109. In other countries such as Ethiopia, Kenya, Morocco and Uganda, these services do exist, but according to the SMEs, their effectiveness is very low. Take the case of Kenya. The country lacks trade point facilities and support for obtaining information on export markets. The Export Promotion Council promotes trade fairs and exhibitions, but these do not appear to be oriented to SMEs, which limits their potential benefits.

110. Many countries envisage to provide SMEs with marketing and advertising supports. These services are supposed to help companies in selling their products on local and export markets at the request of the suppliers by organising exhibitions and trade fairs, and by facilitating the exchange of experiences among enterprises through seminars and workshops. However, the beneficiaries of such support questioned the usefulness of the agencies run by governments.

111. Likewise, the Moroccan government created the Centre for the Promotion of Enterprises to improve management and export-marketing expertise in the SME sector through training. Again, entrepreneurs report that they are not adequately trained in international marketing, and lack information on trade contacts and business opportunities. Overall, they indicate that the institutional support received in the area of marketing is inadequate.

Box 5: Export Financing in Morocco

I. Financing

Export enterprises have various financial instruments used for export purposes, such as export prefinancing, mobilization of cross-border claims, and factoring.

A. Export prefinancing

This type of credit serves to finance cash flow requirements for export purposes, and in particular, stock, manufacturing or market performance, building up stocks locally or extraterritorially, and so on. The financing quota is 10 per cent of the export-based turnover; for seasonal activity, this may reach 15 per cent. The maximum life of the prefinancing obligation is one year, and is renewable.

B. Mobilization of cross-border claims

This type of financing enables the enterprise to meet various requirements connected with the final phase of cross-border trading. With a line of bank credit for financing cross-border claims, an exporter can seek advances varying in amount according to the volume of exports. Cross-border claims may be mobilized in dirhams or in foreign exchange. Mobilization in foreign exchange may be effected through a Moroccan bank or a foreign correspondent. In the former case, the exporter may either discount the claim with the bank, or obtain an advance thereon.

Mobilization with a foreign bank is effected with a view to repatriating the proceeds of sale ahead of maturity, or financing the importation of primary products or commodities for use in the manufacture of goods destined for export. Claims in respect of which the remaining term of payment is at least 30 days are eligible for mobilization with foreign correspondents. For prefinancing and advances in dirhams on export-based claims, the applicable interest rate is established by reference to the bank base rate for export credit (currently, 8.5 per cent for short-term credit), plus a markup corresponding to the risk premium. Moroccan banks are encouraged, in granting credit financing and advances on export-based claims, to adopt the following mechanisms: (a) use the "export" paper supporting advances made by the Banque al-Maghrib on the money market, and (b) factor in the "export" paper in computing the liquidity coefficient as required by the monetary authorities.

C. Factoring

Factoring enables the exporter to cover the purchaser's risk and anticipate the repatriation of the export-based claims. In that connection, an application containing all the necessary information on the commercial transactions to be covered, should be sent to the bank or factoring enterprise. The factor guarantees the purchaser's risk if the details given are satisfactory. Factoring is effected as part of a contract between the factor and the exporter. The exporter signs a letter of attorney authorizing the factor to recover the export revenues that are the subject-matter of the contract. In general terms, Moroccan banks are empowered, in respect of external credits for financing their export and investment operations in Morocco, to enter into contracts directly or through a Moroccan bank.

II. Export Insurance

The Société marocaine d'assurance à l'exportation (SMAE) manages the export insurance system autonomously and, under government supervision, oversees ordinary trading risks relating to credit insurance. Export insurance comprises the following categories of guarantee:

- (a) exhibition insurance;
- (b) venture insurance; and
- (c) credit insurance.

A. Exhibition insurance

This type of insurance guarantees exporters participating in a trade fair or exhibition abroad, reimbursement of part of the expenses incurred in connection with such participation, in the event of non-realization of a turnover sufficient to cover those expenses, and in particular, expenses relating to;

- (i) rental and installation of the stalls;
- (ii) transportation and packaging of the items for exhibition;
- (iii) advertising;
- (iv) transportation insurance; and
- (v) travel and accommodation of representatives. However, the reimbursement is limited to 50 per cent of the total expenses actually incurred.

B. Venture insurance

Venture insurance guarantees the exporter seeking new outlets, reimbursement of up to 50 per cent of the expenses incurred in the event of the venture being fruitless or producing inadequate results. The areas covered may comprise the totality of the national territory. Venture insurance may be in the form of normal venture insurance or simplified venture insurance.

1. Normal venture insurance

This type of guarantee is intended to benefit industrial, commercial and/or service enterprises or combinations of the same;

It covers a broad range of expense items, such as market research, foreign travel and representation abroad;

- The insurance contract is drawn up on the basis of the agreed expenditure projections on new ventures. The life of the contract, which may vary between 3 to 10 years, consists of two periods of equal duration: (i) the guarantee period during which the insured receives compensation computed in accordance with the contractual provisions, in the event that no sale is realized on the markets sought in the new venture. (ii) the period of supplementary amortization, during which the insured wholly or partially repays the compensation received, in accordance with the volume of the turnover realized over the areas covered.
- The cost of the guarantee comprises a registration fee, and a premium payable only during the guarantee period. The premium equals 3 per cent of the agreed expenditure projections.

2. Simplified venture insurance

- This type of guarantee is intended to benefit SMIs with an annual export turnover not exceeding DH 1 million, as well as enterprises with a short experience in export activity (i.e. less than two years).
- It functions along the same principle as the normal venture insurance. However, it has a simplified formula in that it allows the exporter to present an overall budget (i.e. not broken down by country or occupation), and there is an overall ceiling.

An added advantage is that it enables the exporter to enhance his/her contract with a view to obtaining prefinancing for new ventures.

112. On the other hand, support services in Namibia and Nigeria appear to have had a positive, but still limited, impact on companies' marketing potential. For instance, the government of Namibia has undertaken a number of initiatives aimed at helping SMEs to access market information. Box 5 shows the very interesting vendor programme initiative to improve market access by SMEs. This is considered to be beyond the financial ability of SMEs: even the very few that use computers do so only for word processing.

Box 6: Facing the market challenge: the Namibian response

The vendor development programme is a scheme that the government of Namibia initiated to address the market problem and is designed to contribute to:

- Improving market access for small businesses;
- Capturing, within Namibia, of a great proportion of what the Namibian consumer, large businesses and government spend. The programme will also be used to establish more small businesses, and to expand and diversify existing businesses;
- Improving the structure of and trading relationships within the Namibian economy by linking large businesses with small suppliers;
- Improving sector linkages.

113. A number of support services for marketing SME products on regional and global markets are in place in Nigeria. For instance, the Nigerian Export Promotion Council (NEPC) carries out market studies and other promotional activities. It also assists SMEs to participate in international trade fairs and exhibitions. At the private sector level, institutions involved in the provision of marketing support services include the National Association of Chambers of Commerce, Industries, Mines and Agriculture, chambers of commerce and industry in the various states, and bilateral chambers of commerce. In spite of this multitude of institutions, the system seems to lack information on international markets for inputs and sales, and on domestic suppliers, purchasers and market trends. However, some institutions appear to have done well in the provision of marketing services to SMEs. For instance, according to the mission report, the chambers of commerce of Lagos, Kaduna and Enugu are well organised and seem to have promoted fairs and exhibitions on a regular basis.

114. The most developed and effective marketing support services in Africa appear to have been promoted by the governments of Mauritius, South Africa and Tunisia. In Mauritius, MEDIA is the main marketing support institution. It provides market surveys on export opportunities, and up-to-date advice and information on Mauritian products, services and investment opportunities. It also organises the Mauritius International Trade Exhibition and facilitates buyer/seller meets. According to a survey conducted by the Commonwealth Secretariat (Wignaraja and O'Neil 1999), the awareness of MEDIA's activities is very high, but the perception of the usefulness of the institution is highly dependent on the outcome. The general feeling is that MEDIA is an organisation geared to meeting the needs of the larger firms, since smaller companies do not have the resources to participate in international fairs. Despite the criticisms, it is important to note that the institution's activities and projects seem to be highly innovative by African standards. Box 6 shows another interesting initiative to promote marketing in Mauritius.

Box 7: Sub-contracting and partnership exchange - Mauritius (SUBEX-M)

An interesting marketing mechanism in place in Mauritius is the sub-contracting and partnership exchange programme, established in 1997.

It promotes sub-contracting arrangements between large and small/medium enterprises at national, regional and international levels. Its specific objectives include: creating a data bank on potential sub-contractors and customers; providing information on outsourcing possibilities in response to enquiries; and providing technical assistance to improve manufacturing capabilities in SMEs on an occasional basis.

It also organises annual trade exhibitions with a view to promoting sub-contracting. So far, it has organised exhibitions in Madagascar and Mauritius, attracting exhibitors from all over the world.

Source: Wignaraja and O'Neil, 1999.

115. In South Africa, NTISIKA is responsible for marketing-related services to SMEs. It helps companies to win tenders from the public sector, improve their access to international markets, participate in national and international exhibitions, and buy raw materials in bulk at lower prices. The Department of Trade and Industry provides exporters with a range of incentives under its marketing and investment assistance scheme. These incentives are extended to all companies regardless of their size and include the provision of compensation for costs incurred in developing new export markets and participating in foreign exhibitions.

B. International best practice

116. Providers of producer services can play a major role in the diffusion of technology, acquisition of technical knowledge, identification of niche markets, strengthening of marketing capabilities and promotion of inter-firm co-operation (Helmsing 1998, Levitsky 1995, Levy, 1994). Although they are not directly responsible for the overall economic performance of SMEs, the international experience shows that they can play a significant role in strengthening their technological and marketing capabilities. The main aim of this section is to use the international experience to identify best practices for the provision of support services. What sort of institutional features have shown to be relevant for service providers to have a positive impact on SMEs' technological and marketing capability building. Although it is very difficult to replicate successful models of institutional support, international best practice experiences should be taken into consideration in the design or reform of support programmes and projects.

117. The international experience suggests the following lessons for effective provision of support services to SMEs (Albaladejo, 2000; ILO, 1998; Humphrey and Schmitz, 1996):

- Service providers should be located close to the industries they serve. Close location to SMEs means reduced transaction costs and a quicker response to technical problems. In developing countries, policymakers should ensure that

centralised administrations and bureaucratic barriers do not impede the right location of these institutions.

- Service providers should benefit SMEs more than large firms, especially in developing economies where the difference between them is more acute. Membership entrance fees should not be flat and prices for services should be fixed according to firm size. If possible, such prices should be lower than market prices for the same or similar services provided that their provision is sustainable.
- Policymakers in developing countries should ensure that service centres adopt an approach focused on groups of small firms rather than individual firms. This collective approach reduces transaction costs and can strengthen inter-firm co-operative links, which have contributed positively to the innovation capacity and overall performance of SMEs.
- Service providers should be responsive to industry's demands, reacting to the needs of their customers, but also acting as "industry leaders", encouraging firms to change their technology and organisation according to their perception of "best practice".
- Sector-oriented institutes can be crucial for the welfare of particular industrial sectors because they tend to reflect the specific needs of the SMEs they serve. A participatory approach to the planning and design of policy interventions offers the advantage of a more precise understanding of SME needs. In order to achieve this, a good number of SME representatives should be part of the board of supervisors of every single institution that intends to support them. Policymakers intending to foster the development of a particular industrial sector should be aware of the great benefits of sector-oriented institutes and the importance of SME involvement and participation in policy design and intervention.
- Service providers should be run on a business-like and demand-led basis to ensure their sustainability. Clients' having to pay for service provision is a good indicator of an institution's credibility and relevance, sharpening the way both clients and counsellors perceive it. The higher the SME control and ownership, the higher the institution's capacity for sustainability and success. Support policies designed and implemented with the help of SME representatives tend to result in more practical, cost-effective and realistic technical services.
- An effective service support system does not rely as much on the number of institutions actively functioning as on their networking and appropriate co-ordination. SME support strategies would definitely benefit from institutional interaction at different operational levels.

118. In the area of technology, skills, and marketing development, international experience suggest the following:

- Service providers should foster the innovation and production capabilities of local firms, making good and rational use of external sources (e.g. facilitating the transfer and use of appropriate technology in SMEs).
- In order to reduce the limitations on innovation, support services should be designed on the basis of the indigenous capacities of local firms and the spread of technologies through a process of inter-enterprise learning. Service providers should act as intermediary agencies contributing to technological

diffusion and upgrading in companies. The initial move must come from the private sector, with supporting institutions facilitating and strengthening processes already under way.

- Focusing on R&D-intensive services to encourage SMEs to move towards more innovative and therefore higher value-added products. For instance, Albaladejo (2000) shows how a local institution has encouraged R&D activities in SMEs by having a yearly competition in which an award is given to the most innovative firm, and by producing a catalogue with the most innovative local products.
- Putting science on the shop floor by having technological commissions where scientists and entrepreneurs work together. For instance, Albaladejo (2000) provides insights into how these technological commissions work. In this case, commissions are made up of around 20 people (comprising firm representatives and engineers/scientists hired by the institution) whose aim is to provide cost-effective solutions to the industry's bottlenecks in three fields: engineering, skills and quality standards. International experience shows that this can be one of the most practical and efficient ways to increase innovation within firms.
- Increased technological capabilities mean nothing if there is no niche market where the new product can be sold. Otherwise, there is no incentive for entrepreneurs to improve quality, invest in fashion and design and so on. Thus, service providers should not forget the final stages of the production process (i.e. marketing and commercialisation), and marketing research should be encouraged in SMEs to find out about the viability and prospects of new innovations.
- Trade fairs provide an excellent opportunity for firms to market their products, learn about customer needs, and eye up the competition. But for small firms the costs of exhibiting, particularly in international fairs, can be prohibitive. A shared stand allows producers to put on a more impressive show and face the world's buyers and competitors with greater confidence. Public agencies or private collective organisations can provide financial and technical assistance to groups of firms, enabling them to share stalls.
- Another demand-oriented and tested measure is support through partnerships between large firms and their small suppliers. To upgrade the capacity of the small firms, the support programme can hook into existing supply arrangements using the large customer as the entry point for reaching the small suppliers. Key to this approach is that the suggested improvements can be practised in existing orders. The cost can be shared between the large customer, the small suppliers and the supporting agency. Such schemes also involve larger firms in the technical problems of smaller firms, which brings new resources to bear.

VIII. Conclusion and recommendations

119. This paper provides a first step towards the design of ECA's strategic framework to enhance the competitiveness of African SMEs in regional and global markets. The purpose of this final section is to identify priorities for policymakers and practitioners and to provide the building blocks for a strategic framework to help African SMEs compete in regional and global markets. The objective is not to provide a blueprint for action in all African countries. This would not help. As shown in this report, African economies are at different stages of development. Their needs and their capacity for action differ greatly. Nevertheless, a number of common issues can be identified and common priorities emerge for the least developed countries.

120. An overview of Africa's industrial indicators reveals its low capabilities and relatively poor performance in exports. The region lacks a base for technical-skills formation and its enterprise-financed R&D is the lowest in the world. Moreover, political instability, macro-economic turbulence and deficient infrastructure seem to have prevented the region from attracting foreign investment, limiting its ability to participate in the global economy. However, exceptions within the region have been noted. Countries such as Morocco, Mauritius, South Africa and Tunisia have shown promising signs in their industrial strategies, exhibiting considerable human resources and technological capabilities.

121. In order to provide realistic policy recommendations for helping African enterprises to compete in regional and global markets, one needs to understand internal processes and external factors leading to the building of technological and marketing capability in enterprises. Although it is widely acknowledged that companies' own technology efforts (e.g. investment in human development, information technology, etc) are required for improved performance, this is often an uncertain, risky and costly process, especially for SMEs with limited resources. International lessons on SME development show that external factors such as inter-firm co-operation and institutional support can play a key role in helping SMEs to build up internal capabilities to compete in regional and global markets. As far as institutional support is concerned, this report distinguishes between policies for improving the regulatory and policy environment and policies to provide financial and non-financial assistance to SMEs. Support services in technology and marketing have been the main focus of this report.

122. Although empirical evidence from the ECA mission reports suggests that policy intervention is required at all levels to help African SMEs, prioritising such interventions appears to be the first step towards designing a feasible strategic framework to support SMEs in Africa. This needs to take into account the fact that the same policy lessons cannot be drawn for the continent as a whole since the development levels of SME support structures in Africa differ widely. With this in mind, the report presents three basic levels in the state of SME support structures in Africa. This distinction would help policymakers in identifying priorities for countries facing similar obstacles.

- Level I: Countries with severe deficiencies in infrastructure and a disabling regulatory environment.

- Level II: Countries with less severe deficiencies in the "basics" (good infrastructure and regulatory framework) but weak financial and non-financial institutions.
- Level III: Countries that have good basics for industrial activity and an efficient SME support structure (by African standards), but require further improvement in policies and support services.

123. Findings from the mission reports suggest that the basic infrastructure for industrial development in Africa is often very weak. The lack of functional and reliable basic physical and IT infrastructure has indeed weighed against the competitiveness of African SMEs. Apart from a few exceptions, the overall picture is that little progress has been made in improving infrastructure facilities in the region. Improving infrastructure beyond Level 1 is a priority if SME development is to be accelerated. This comes out clearest in a recent study by Milner, Morrissey and Rudaheranwa (2000) on policy and infrastructure barriers to trade in Uganda. The study concludes that improving infrastructure is the single most important task for raising exports to neighbouring and more distant countries. The same would seem to apply to many other African countries. Major improvements in infrastructure have become an imperative for three reasons: (a) the internal market of most African countries is too small and exports to neighbouring and distant markets are essential to deepen the division of labour and reap efficiency gains; (b) the new competition puts a premium on product quality and speed of delivery, which are impossible to achieve without adequate infrastructure; (c) e-commerce will further raise the need for better infrastructure, both in telecommunications and transport of goods.

124. The importance of investing in infrastructure development is widely acknowledged and commonly accepted. This is an area in which donor agencies could play a significant role. SMEs have become one of the most favoured target groups of many multilateral and bilateral donors. However, their efforts and resources have tended to go into complicated financial and non-financial support projects. Greater attention to infrastructural projects might be a more appropriate focus for their considerable financial resources.

125. The regulatory and policy environment in Africa continues to present obstacles for SMEs. Laws and regulations are often complex, increasing the transaction costs of SMEs, and the lack of transparency in implementation diverts the benefits from the ultimate beneficiaries. However, unlike in the case of infrastructure development, a substantial number of African countries have seen major improvements in their regulatory systems over the last years. The mission reports show that countries have adopted different policy strategies to provide a friendlier environment for SMEs. While some African countries have tried to simplify legal and accounting procedures to reduce transaction costs in SMEs, the more pro-active countries have also provided fiscal incentives to stimulate growth in SMEs. If policy support for infrastructure development seems to unify public opinion, policies to improve the regulatory environment are often more contentious and controversial. It is not just a matter of what is to be done but also how to achieve policy harmonisation and gradual implementation of such initiatives.

126. Responding to the new challenges and pressures requires effective support services. It is clear that increasing trade liberalisation in Africa represents a new challenge for SMEs. On the one hand, the opening up of national economies to global

markets has increased SMEs' prospects and opportunities, but on the other, it has also increased international pressure to upgrade and become more efficient. Evidence from the mission reports suggests that in Africa only South Africa, Mauritius and perhaps Tunisia (clearly at Level III) have responded to trade liberalisation and improved their institutional support systems. Figure 5 seeks to provide some guidance to policymakers and highlights the fact that good governance is about finding the right balance between challenge and support.

Figure 5: SME market challenges and policy support



127. The horizontal axis shows the degree of SME support and the vertical axis shows the severity of the challenge. For the sake of simplicity, the figure distinguishes only between low and high support and between low and high challenge. Up to the 1980s or early 1990s, most SMEs found themselves in quadrant 1: the challenge they confronted was low (due to protection from outside competition) but the institutional support they received was also low. Import liberalisation in the 1990s pushed them into quadrant 3, which meant sudden high challenge but continuing low support. Studies on the supply response of local firms make it clear that this strategy yields poor results (Kaplinsky and Morris 1999, Morissey 2000). “Macro-economic reforms and measures are necessary but not sufficient to induce a domestic supply response” (Eshetu 2000: 18). The quadrant to be targeted in future SME strategy is number 4 (in Figure 5), which represents high challenge and high support. This is the combination most likely to lead to a thriving SME sector.

128. Identifying existing deficiencies in the support systems and relating them to the lack of either general economic policies or SME-specific policies is an important step towards prioritising interventions. This helps to distinguish between requirements relevant for all enterprises (regardless of size) and those which are particular to SMEs. General policies are concerned with the basics for industrial activity (i.e. infrastructure and the regulatory and policy environment) while SME-specific policies refer to the direct interventions geared towards improving companies' accessibility to financial and non-financial services. It is of key importance to know where policy should be put to work first. The next five points should help policymakers identify policy priorities for SME development in Africa.

129. First, the effectiveness of any support system is highly dependent on the existence and quality of the so-called basics for industrial activity, notably good infrastructure. This does not mean that the countries concerned should just focus on investing in infrastructure. It does mean, however, that policymakers need to identify the countries' key bottlenecks for industrial development in order to prioritise interventions.

130. Second, the existence of supporting institutions does not guarantee the effectiveness of the whole support system. Indeed, evidence from the mission reports shows that even where there is a range of support institutions, effective financial and non-financial support is often not available.

131. Third, responsibility for effective support does not lie with government alone, but government is a key actor, particularly where markets do not yet provide effective producer services. This is why they received the most detailed attention in this report (Sections 6 and 7). The principles which define good practice in the provision of support services are that effective service providers should:

- Be located close to the industries they serve in order to reduce transaction costs in SMEs;
- Be run in a business-like manner to guarantee cost recovery;
- React to the needs of their customers, but also act as “industry leaders”, encouraging “best practices”;
- Adopt a collective and participatory approach focusing on the needs of groups of enterprises rather than individual firms;
- Foster vertical and horizontal inter-firm co-operation and strengthen existing networks, especially with global players;
- Interact with other institutions providing services for SMEs so as to co-ordinate support efforts.

132. Given the focus of this report, service providers supplying services for technology and marketing capability building should:

- Foster the innovation and production capabilities of local firms, making rational use of external sources;
- Provide services designed on the basis of the existing indigenous capabilities through a process of inter-enterprise learning;
- Put science on the shop floor and encourage in-firm R&D activities to move towards more innovative and higher value-added products;
- Provide marketing information and encourage marketing research in SMEs;
- Provide financial and technical assistance for groups of firms to share stalls in international trade fairs;
- Facilitate partnership arrangements between large firms and small suppliers.

133. Four, bearing in mind the assumptions on priorities described earlier, a strategic framework to support SMEs in Africa should consider the different intervention levels.

- For countries at Level I, emphasis should be placed on general economic policies required for industrial development.
- For countries at Level II, emphasis should be placed on designing specific policies to overcome existing inefficiencies in the SME support system.
- For countries at Level III, emphasis should be placed on identifying gaps and improving the existing support system using international best practices.

134. Five, even if gradual liberalisation has been accompanied by purposeful institutional intervention, it might not be enough. There is also a need for insertion in international value chains so that the gains from globalisation may be spread. The insertion of SMEs into global or regional value chains is critical for upgrading their products and processes. In an increasing number of sectors, developing-country

producers need access to the chains' lead firms in order to export. These lead firms 'undertake the functional integration and co-ordination of internationally dispersed activities' (Gereffi 1999:41). Africa's main success story in exporting – horticulture – is an example of what can be achieved through integration into buyer-driven chains (Dolan and Humphrey 2000). There are also problems associated with this strategy of joining regional and global chains (Gibbon 2000, Schmitz and Knorringer 1999) but it would seem that the issue is not whether to integrate but how. The mode of insertion needs to be managed. (<http://www.ids.ac.uk/ids/global/glores.html>)

135. The question then is how to operationalise the concern with connectivity. This is where ECA has an important role to play. It can provide technical assistance to African government agencies and business associations by mapping the global and regional value chains that are most relevant to them. Mapping such chains helps to identify (a) where the critical bottlenecks are for the flow of materials and information, and (b) where there are leverage points at which a little action (pressure/incentives) can yield big results. There are two tasks which ECA could carry out most usefully: first, conducting policy-oriented value-chain analyses for a small number of countries and sectors which could serve as role models. Second, putting together a guide that helps interested government agencies, business associations and NGOs to map their own value chains. Participatory techniques drawing on the contribution of all relevant stakeholders, can be built into value-chain mapping and analysis.

136. The importance of the connectivity thinking is underlined by The Global Compact, a new initiative launched recently by the Secretary-General of the United Nations, Kofi Annan. The Global Compact seeks to provide a new framework for public-private partnership. One of the central ideas is that the "muscle" of global buyers and producers can be used to upgrade local suppliers. The emphasis is on, first, co-operation (between local SMEs and large companies, especially transnational companies; and between the public and private sectors) and, second, integration in the global economy.

137. Critically, however, the goal is not integration at any price. Participating in the global economy by taking the low road to competitiveness (disrespect for human rights, labour and the environment) goes against the principles of the Global Compact (<http://www.unglobalcompact.org/>). In this spirit, a number of bilateral agencies (for example DFID of the UK and GTZ of Germany are developing new programmes of public-private partnership aimed at strengthening SMEs, particularly in the poorest countries (<http://www.gtz.de/ppp>; <http://www.dfid.gov.uk/>). Similarly, multilateral agencies are entering new territory and have organised expert group meetings on 'Partnerships with Private Business', UNIDO, 30-31 October 2000, and on 'The Relationships between SMEs and TNCs to Ensure the Competitiveness of SMEs', UNCTAD, 27-29 November 2000. New ideas, energies and resources are brought to bear on the common concern with upgrading SMEs in developing countries (UNCTAD 2000; UNIDO 2000). It is important for ECA, African governments and business associations to seize the momentum and work with those organisations in the public and private sector which are spearheading the new approach.

138. It is essential, however, to keep in mind, first, that such partnerships are only likely to develop where certain preconditions exist in terms of infrastructure and regulatory frameworks. Second such partnerships are no panacea for SME development. They will help only some SMEs directly. Nevertheless, they highlight the

new emphasis on connectivity. Directing efforts and resources at those points which help SMEs to tap relevant knowledge flows and insert themselves into regional and global value chains would seem to be the priority for SME policy. ECA can play a major role in the diffusion of such thinking and in helping interested governmental agencies and business associations with operationalisation.

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