

FOCUS ISSUE 4: REGULATORY AND INSTITUTIONAL ENVIRONMENT FOR THE PRIVATE SECTOR

I. Overview of the Commitments

Since NEPAD's founding statement of October 2001, African governments and their development partners have ranked private sector growth among their top priorities. Several action plans and landmark declarations also place particular emphasis on a sound business climate that enables the private sector to increase its investments and activities. Despite these broad statements, there have been few very specific targets in this area, although there are many general policy statements, and statements of intention.

Africa:

- ◆ The New Partnership for Africa's Development (NEPAD) declaration (October 2001) (paragraph 150): "seeks to increase private capital flows to Africa as an essential component of a sustainable long-term approach to filling the resource gap". The NEPAD Declaration (July 2001) on Democracy, Political, Economic and Corporate Governance (AGH/235 (XXXVIII)): seeks to encourage private financial flows and new partnerships between governments, the private sector and civil society, as well as approves eight prioritized codes and standards for achieving good economic and corporate governance.
- ◆ The Abuja Declaration on Democracy, Political, Economic and Corporate Governance, (2003, paragraph 23) states: "We, therefore undertake to foster new partnerships between government and the private sector; a new division of labour in which the private sector will be the veritable engine of economic growth...".
- ◆ The Maputo Declaration (June 2004) by the Heads of State and Government of the African, Caribbean and Pacific Group of States (ACP countries) included a section on private sector development stating: "We re-affirm the role of the private sector in development. As an engine of economic growth, the private sector is an important actor whose role can complement governmental action in the development process. Therefore, we remain committed to creating suitable conditions for its enhancement which are central for economic growth. ...".
- ◆ The AU Private Sector Forum at its meeting in Addis Ababa (June 2004) called on the African Union to mobilize and intensify its efforts to strengthen the African Private Sector through the creation of the necessary enabling environment for the promotion of trade, investment and industrialization and the effective organization of the African private sector both in the Continent and in the Diaspora.
- ◆ At its tenth Ordinary Session in Addis Ababa, (January 2008), the AU committed itself, *inter alia*, to: establish and strengthen the legal and institutional frameworks for the promotion of African industrial enterprises at national, regional, continental and international levels; and to achieve the harmonization of African business laws.

Development partners:

- ◆ The G8's Africa Action Plan, agreed at Kananaskis in 2002, undertook to support African initiatives aimed at improving the investment climate, including sound economic policies and efforts to improve the security of goods and transactions, consolidate property rights, modernise customs, institute needed legal and judicial reforms and help mitigate risks for investors.

- ◆ At Gleneagles (2005), G8 countries agreed to improve the investment climate “... through the promotion of a stable, efficient and harmonised legal business framework (noting the work of the Organization for the Harmonization of Business Law in Africa (OHADA) business legal unification process and the improvement of the investment climate through the OECD/NEPAD Investment Initiative) and increased access to finance including strong support for the development of micro-finance in Africa.” They also agreed to support investment, enterprise development and innovation, for example, through support to the AU/NEPAD Investment Climate Facility, the Enhanced Private Sector Assistance with the AfDB, and other appropriate institutions; to invest in SMEs and microfinance, and through actions by the relevant International Financial Institutions and African governments to increase access to financial services through increased partnerships between commercial banks and micro-finance institutions, including through support for diversification of financial services available to the poor and effective use of remittances.
- ◆ At Heiligendamm (2007), the G8 committed themselves to “support African countries in their efforts to remove the obstacles hampering more investment and to reduce the cost of doing business”.
- ◆ At Toyako in 2008, the G8 confirmed its commitment to working with Africans to create conditions that can lead to an increase of private investment through various measures including *inter alia*, improvement of business environment, and strengthening the financial sector including increase of domestic savings and SMEs access to financial services.
- ◆ The Africa-EU Strategic Partnership (2008) confirms that ‘investments in private sector development will be promoted, looking in particular to youth and women’.

II. What has been done to deliver on these commitments?

Africa:

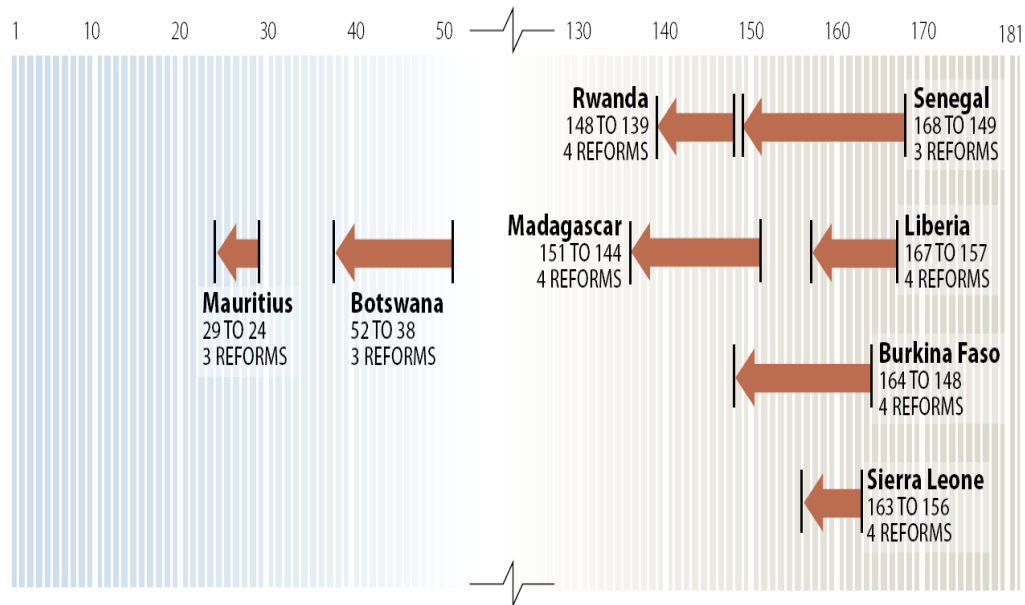
A. *Enabling Business Environment for Private Sector Development (PSD) in Africa:*

- ◆ Good progress has been made in strengthening the environment for private sector development in some parts of Africa. A number of countries have improved the efficiency of the **administration of commercial law**, and have strengthened **property rights**.
- ◆ In 2007-2008, according to Doing Business, a total of 28 African countries implemented 58 reforms which have made it simpler to start a business. They have strengthened property rights, enhanced investor protections, increased access to credit, eased tax burdens, and expedited trade while reducing costs. Four African countries — Botswana, Burkina Faso Egypt and Senegal — were amongst the top ten performers across 181 countries for improvements in their economies that eased the terms of doing business. Another three - Ghana, Mauritius and Egypt - were the top reformers in Africa in terms of the ease of doing business for the period from January 2005 to June 2007. And Mauritius joined the top 25 globally for ease of doing business.
- ◆ Three post-conflict countries in Africa are reforming fast too, and are among the most active reformers of recent years.

Figure 1. Business Reform in Africa

Who reformed the most in Africa in 2007/08?

Improvement in the ranking on the ease of doing business, DB2008–DB2009



Source: Doing Business database

Note: The figure above shows the number of places a country has moved up the rankings list in the Doing Business reports between 2008 and 2009, and the number of reforms that lie behind that improvement.

- ◆ Registration requirements and fiscal procedures for various business start-ups have been eased in a number of countries, making it easier for companies to operate in the formal sector and facilitating their access to credit.
- ◆ Ghana created the Ministry for Private Sector Development and Presidential Special Initiatives in 2001 in view of the importance of the sector in national development. Furthermore, the Ministry has developed a National Medium-Term Private Sector Development Strategy (NMTPSDS). This prominence given to private sector development and the associated policy changes has had major success.
- ◆ A number of countries strengthened property rights by making it easier to transfer titles on real estate, or reducing the cost of property registration. Mali and Niger sped up property registration by decentralizing and reorganizing their registries. Nigeria cut the average property registration time from 274 to 80 days. Lesotho adopted a new law allowing married women to transfer land without their husbands' signature.
- ◆ Some countries implemented reforms in registration tax. Burundi abolished its property registration tax. Benin and Guinea-Bissau reduced their rates for such taxes. Niger also cut the registration tax to 5% of the property value, greatly reducing the total cost.

Box 1: Regulatory reform benefits women entrepreneurs

The World Bank's Cost of Doing Business Report 2008 finds that higher rankings on the ease of doing business are associated with higher percentages of women among entrepreneurs and employees. "The benefits of regulatory reform are especially large for women," said Sylvia Solf, an author of the report. "Women often face regulations that may be designed to protect them but that instead force them into the informal sector. There women have little job security and few social benefits," she added. In the Democratic Republic of Congo, where women need their husbands' consent to start a business, they run only 18% of small businesses. In neighboring Rwanda, which has no such regulations, women run more than 41% of small businesses.

B. Strengthening Institutional Capacity

- ◆ In recent years, many African countries have taken steps to improve the way business contracts are enforced. More efficient contract enforcement may increase bank lending and the use of the judiciary system by businesses, and reduce the average cost of doing business, especially for small businesses, and the judiciary budget.
- ◆ There have been a number of improvements to the legal and judicial system, such as making improvements to court efficiency, for example by introducing a specialised commercial division in the high court.
- ◆ Countries have also created and/or strengthened a one-stop shop for new businesses, for instance Burkina Faso created; Kenya strengthened its investment promotion agency (IPA).
- ◆ The most popular reforms have been the introduction of specialized commercial chambers in general courts and the setting up of separate commercial courts. The main benefit of introducing specialized courts is the efficiency gains of having judges with expertise in handling commercial cases and their streamlined procedures. Table 1 below summarises the reforms undertaken by countries to introduce specialized commercial courts.

Table 1. Country reforms in introducing specialized commercial courts

Burkina Faso	Introduced specialized commercial chambers in the general courts. Since October 2006 commercial chambers have been operating in the general courts in Ouagadougou and Bobo-Dioulasso
Chad	The commercial court in N'Djamena started operating in October 2006
Congo DRC	In August 2006 specialized commercial courts started operating in Gombe; and in Kinshasa in November 2006
The Gambia	Established a commercial division in the high court during 2005/06
Ghana	Six commercial courts are now fully operational in Accra
Malawi	The commercial division of the Blantyre High Court started hearing cases above 50, 000 kwachas since May 2007
Mauritania,	During 2006/07, commercial courts replaced commercial chambers in the general courts
Mozambique	Specialized commercial chambers have been operated in the general courts in Maputo since March 2007. Legislation replaced with a new commercial code that introduces stricter corporate governance rules and strengthens the rights of minority shareholders.
Nigeria	Lagos State introduced a specialized commercial division in the high court during 2005/06
Rwanda	In March 2006, commercial chambers started operating in the high courts; 3 separate commercial courts were established in May 2007

Source: World Bank (2005a, 2006d, 2007a).

C. *Access to Finance*

- ♦ In many countries better and more predictable monetary policies are improving the environment for banking. Privatisation of state-owned banks has created opportunities, and better regulation has helped.
- ♦ In order to increase access to finance, innovative financial operators, strong regional banks, and ICT and mobile phone technology are helping to open up new possibilities and are bringing the provision of financial services to a much larger number of Africans.

Development Partners:

- ♦ A number of measures aimed at helping African partners improve their business environment, promote investment and help develop financial markets have been undertaken by the international community, including:
 - The “Enhanced Private Sector Assistance (EPSA) for Africa”, an initiative agreed at the G8 Gleneagles Summit in July 2005 between the Government of Japan and the African Development Bank.
 - A Partnership for Making Finance Work for Africa, an initiative that recognises the need to work more closely together to strengthen financial sector development in Africa has been formed to support African partners’ improve access to finance, and so enable poor people – women in particular – to increase their incomes and build assets.
 - The Foreign Investment Advisory Service of the International Finance Corporation, which advises governments of developing and transition countries on how to improve their investment climates for domestic and foreign investors. FIAS focuses on regulatory simplification, industry-specific investment climate issues, and investment policy and promotion.
 - The NEPAD/OECD Africa Investment Initiative and the Investment Climate Facility, which is an independent trust with strong African representation on the Board of Trustees. It provides a mechanism through which the private sector, the G8 countries, other donors and African governments and institutions can support Africa's vision for sustainable growth and development.
 - The African Development Bank through its private sector window has strongly supported the development of public-private partnership (PPP) in Africa through financial and technical assistances to regional member countries and strategic private sector partners. To improve PPP management in Africa, in particular in infrastructure development, UNECA- supports African countries through the PPP Alliance Programme for Capacity Building”.

III. What are the results?

Promotion of Business and Investment

1. Doing business¹ has become easier in some parts of Africa (World Bank “Doing Business 2009”). It is easier for investors to start a business with reduced costs in Africa as a result of recent reforms implemented in a considerable number of African countries that include strengthened property rights, enhanced investor protections, increased access to credit, eased tax burdens, and expedited trade.

2. Several African countries have laws to protect shareholder’s rights. Among these are Djibouti, Egypt, Gambia, Kenya, Malawi, Mauritius, Morocco, South Africa and the countries of UEMOA. Still, there are serious obstacles facing shareholders, especially small shareholders, in protecting their rights (World Bank “Doing Business 2008”).

Regulations and Registrations

3. From January 2005 to June 2007, African countries surveyed in the UNECA African Governance Report II introduced one hundred and fourteen positive reforms in the areas covered by the World Bank’s “Doing Business” study. Reforms to reduce the number of procedures, time and cost to register property were the most popular with 26, followed by reforms to simplify the procedures and reduce the cost associated with starting a business with 24. The largest number of reforms registered during the study period was undertaken by Ghana and Mauritius with eight, followed by Egypt with seven and Kenya with six. Fourteen negative reforms -- that increased the burden on businesses -- were introduced during the same period.

4. Despite this positive progress in reforming the private business environment, the pace of reform on a regional basis shows that Africa still lags behind other regions, notably South Asia and the Middle East and North Africa. In the regional rankings on the pace of reform, Africa’s average rank was 138 (of 181 countries) while South Asia’s was 111 and Latin America and the Caribbean’s was 92 (World Bank “Doing Business 2009”), and the overall costs of doing business in Africa remained the highest in the world.

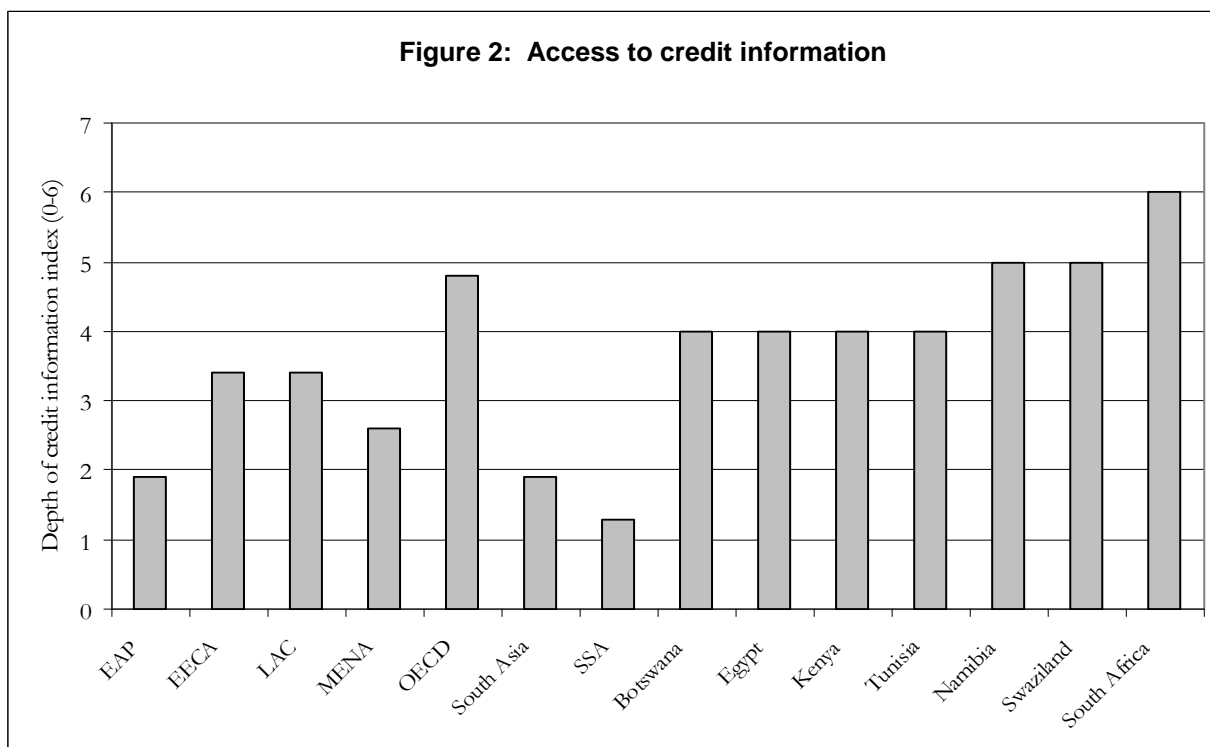
Finance

5. Firm surveys show that access to finance is one of the biggest constraints for enterprise growth. More African firms cite limited access to and high costs of finance as a constraint than in any other region. Although availability of credit for the private sector (at 14% of GDP) is improving, it is still not enough to drive growth and private sector development. If the level of credit going to the private sector had increased from 2008’s 14% to 25% - still a low-income country level -- more than US\$70 billion of additional investment resources would have been made available to African firms and households.

6. A well-functioning credit market requires that lenders be able to have a fair idea of the creditworthiness of prospective borrowers. Quality of credit information in sub-Saharan Africa is generally low (see figure 2 below) although seven countries exceed the average. South Africa is the country which provides the best quality credit information, followed by Namibia, Swaziland, Botswana, Egypt, Kenya

¹ The “Doing Business” rankings track indicators measuring the time and cost to meet government requirements in business start up, operation, trade, taxation, and closure. They do not track variables such as macroeconomic policy, quality of infrastructure, currency volatility, investor perceptions, or crime rates.

and Tunisia. Still, when credit is provided, the terms and conditions are often exorbitant and onerous -- and thus beyond the capacity of most potential borrowers. (ECA 2008).

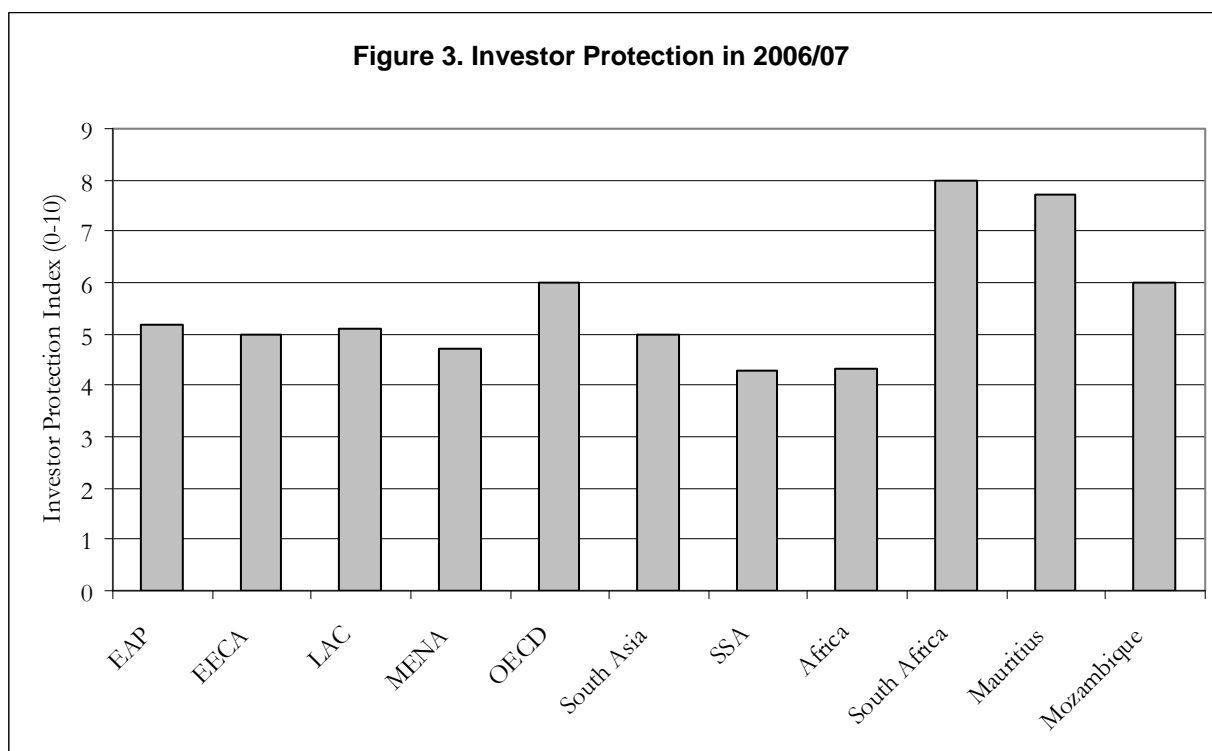


Source: World Bank Doing Business 2008 Database.

Corporate Governance

7. Africa still remains the region with the lowest protection of shareholders as measured by the World Bank's "Investor Protection Index"² in 2006/07. Three African countries – South Africa, Mauritius and Mozambique – have an IP index equal to or higher than the average index for OECD countries (which is 6). South Africa has the strongest shareholder protection regulations in Africa with an index of 8 and ranks tenth in the world in this area. Mauritius, with a ranking of 7.7, has the eleventh strongest investor protection regulations in the world. Swaziland has the weakest investor protection regulations in Africa, with an IP index of 2.

² The Investor Protection Index is the average of three indices: the Extent of Disclosure index; the Extent of Directors' Liability index; and Ease of Shareholder Suit index. Higher values indicate higher shareholder protection (World Bank 2006d).



Source: World Bank Group Doing Business 2008 Database³.

8. A World Bank study (2005) on the observance of OECD corporate governance found that different countries have different situations in terms of observing shareholders' rights. Even where basic shareholder's rights are generally well protected and information is available to shareholders on a regular and timely basis, there are problems with enforcement, especially the disclosure of material facts, monitoring for content and ownership disclosures. Private registries are not regulated and it is impossible even for a sizeable shareholder to nominate a director against the will of the board and management. Controlling shareholders monopolize the annual general meetings through the board. In South Africa, every shareholder has a right to vote at general meetings and on the appointment and removal of directors and auditors, on amendments to articles, on authorization and issuance of share capital. However, shareholders do not exercise these rights due to passivity (World Bank 2003).

9. In a few countries, small shareholders have taken steps to overcome their weakness by forming small shareholders associations. A case in point is Nigeria, where shareholders have established associations as a result of their dissatisfaction with the performance of directors and auditors. The most prominent of these bodies are the Nigerian Shareholders' Solidarity Association (NSSA), the Association for the Advancement of Rights of Shareholders (AARNS), and the Independent Shareholders Association (ISAN). These associations are meant to defend the interest of shareholders in the country. Similar steps have also been taken in Mauritius.

³ The abbreviations used in the charts are as follows: EAP = East Asia and Pacific; EECA = Eastern Europe and Central Asia; LAC = Latin America and the Caribbean; MENA = Middle East and North Africa; and SSA = Sub-Saharan Africa.

10. In general, the picture that emerges from the above discussion is that corporate governance has not advanced much in Africa except for countries in the Southern African region. Corporate governance is still viewed narrowly in terms of its impact on stimulating private investment -- to the comparative neglect of how corporate governance encourages good citizenship by the private sector. Accounting and audit standards and practices fall short of what is internationally acceptable, and the protection of shareholders' rights, especially small shareholders, leaves much to be desired. It was with a view to addressing these problems that the UNECA (UNECA 2002) recommended that at a minimum, African countries endeavor to respect seven international and regional and domestic codes on economic and corporate governance. Little progress has been made by African countries in implementing this recommendation.

IV. What are the key priorities?

Actions by Africa:

- ◆ Recognizing that the private sector can be the engine of growth, and the challenge of attracting external capital flows to supplement domestic investment during a time of financial crisis, more has to be done to create an enabling environment within African countries for domestic and foreign investment by reducing the cost of doing business through simplifying and modernising economic regulations and increasing the utilization of ICT in order to make the African private sector more competitive.
- ◆ Corruption -- which drives up the cost of business transactions -- needs to be significantly reduced. Civil and cross-border conflicts also increase transaction costs, damage the enabling environment for business and weaken the regulatory and institutional framework, and action must be taken to reduce conflict.
- ◆ Strengthen enforcement of legal and judicial reforms, including property rights and the rule of law as well as enhance the protection of shareholder rights and improve corporate governance through a better regulatory and institutional framework.
- ◆ Harmonize business laws and legal frameworks for private sector-driven regional integration to take advantage of economies of scale, thereby promoting intra-Africa trade and investment.
- ◆ Deepen financial markets by improving the efficiency and reach of the banking sector to improve access to financial markets, especially for SMEs, who face severe credit constraints, and expand micro-finance activities. Poorly functioning financial markets remain a major obstacle to business development in Africa, as financial products provided by the banks are generally few in number, while capital markets are still too narrow. The rural and small banking network needs to be greatly expanded, and the indigenous financial sector increasingly integrated into the formal sector to build an inclusive and competitive financial sector in Africa.
- ◆ Improve infrastructure and ease supply-side constraints in African countries to aid private sector development.

Actions by development partners:

- ♦ Further support to African partners for improving their investment climate, including through assistance to legal, regulatory and administrative reforms and measures to facilitate competition, and the accelerated implementation of new mechanisms such as the Investment Climate Facility.
- ♦ Support African efforts to deepen financial markets by improving the management of financial institutions, developing new financial products including insurance and guarantee schemes, and increasing access to financial services