Introduction
Africa's Private Sector

In the summer of 2007, the government of Kenya made an urgent appeal to the Kenya Association of Manufacturers. It asked the members of the association to move their production schedule from their usual hours to a nighttime schedule of 11:00 p.m. to 5:00 a.m. The reason was that Kenya was running out of electricity and was unable to provide power for more than a few hours a day; massive load shedding was required so that the power system would not be overwhelmed. The association acknowledged the problem but wondered how workers would get to and from work in the dark and what sorts of logistical and security costs would be incurred. Kenyan firms already were paying about 4 percent of sales in security costs to keep their workers and equipment safe.

The same summer, President Museveni of Uganda decided to grant 7,100 hectares of Mabira Forest to the Mehta Group, an Asian-owned conglomerate that intended to use the land to grow sugarcane. He explained in a letter to members of parliament that Asian entrepreneurs were crucial to the success of the Ugandan economy and should be given every opportunity to generate jobs for the Ugandan people. But many were not convinced. The immediate reaction was violent rioting, which, according to media reports, resulted in at least two deaths. The opposition Forum for Democratic Change accused Museveni of favoring Asians and pointed out that doing so could lead to racial tensions. Several commentaries in the Ugandan media argued that Mabira Forest was an environmentally sensitive area that deserved to be

Center for Global Development | www.cgdev.org

protected, not destroyed by sugarcane cultivation. The Asian community and the Kampala City Traders Association went to some lengths to assure everyone that their relationship was intact and that the association included several thousand Asian members. Ultimately, President Museveni backed down. But the situation has served to highlight the issue of ethnic minority dominance of the formal private sector—a contentious issue in many African countries.

These are two examples of the key issues affecting the performance and structure of Africa's formal manufacturing sector, which is the topic of this book. Manufacturing constitutes only a modest part of Africa's economies, and generally it has not been their most dynamic sector. Why, then, focus on it in this way? We offer three reasons. First, one of the characteristics of most fast-growing developing countries has been their ability to evolve structurally—away from the primary sector (agriculture) and toward a more diversified mix of the primary, manufacturing, and service sectors—and to move up the technology ladder. While currently high commodity prices may be helping to sustain growth in many African countries, it is likely that without such a structural transformation, their growth will continue to be sporadic and to lag behind that of other countries.

Second, in Africa and other developing regions there has been more extensive study of the manufacturing sector's performance and its links to the business climate than of that of other sectors, such as services and tourism. While some of the factors affecting manufacturing may be specific to the manufacturing sector, many obstacles, whether related to infrastructure or governance and other regulatory factors, will apply to a wider range of formal activity. Third, a look at the structure and makeup of the manufacturing sector can throw light on some of the political economy factors that influence the speed at which countries are ready to implement deep business climate reforms.

Moving forward, perhaps the most important determinant of performance will be the business environment in which firms operate. Does it encourage firms to learn, to invest and grow, and to compete on a global scale? Or does it involve high costs and risks that create disincentives for an entrepreneur who might wish to establish a business, invest in it, or increase its productivity? Is the business environment competitive enough to spur innovation and expansion, or does it impede change?

Particularly in Africa, however, we cannot consider performance without considering "agency"—the capabilities and capacities of the firms themselves, of their entrepreneurs and managers. Are these agents able to take advantage of the opportunities offered by an increasingly open and globalizing Africa? If so, which kinds of owners, managers, and entrepreneurs have

more access to opportunities and which have less? Are there major differences, in particular between indigenous firms and foreign- or minority-owned businesses? If so, what might that mean for the political economy of business-government relations?

That brings us to our discussion of policy solutions. A key question is how to strengthen support for expanding opportunities and the political economy of pro-business reforms. What factors encourage governments to provide essential infrastructure and regulatory services to businesses and to move aggressively to improve the business climate? Is the business community likely to push this agenda, or is it more likely to stand on the sidelines or even to resist reforms? Are the gains from reforms seen as sufficiently attractive to offset the risks, including greater competition? And how are the trade-offs affected by the structure and makeup of the business sector and the size of the market in which it operates?

In focusing on these three topics we concentrate on low-income countries in Africa that have progressed substantially in first-generation macroeconomic reforms. Much of the analysis draws on firm surveys conducted across many African countries between 2001 and the present. Chapter 1 presents an overview of Africa's economies, including data on GDP, economic density, and the manufacturing sector. Africa is distinctive in several ways—in particular, economies are both very small and very sparse, and their manufacturing sectors are modest. These structural factors have several implications for industrial structure and performance, through factors such as the cost of providing infrastructure and the potential for competition.

Chapter 2 presents findings indicating that firms in many African countries bear a heavy burden of indirect costs and losses that make their overall profitability lower than might be expected on the basis of their factory-floor productivity. These findings suggest that despite frequently low productivity and serious skill deficiencies, unit labor costs may not be the binding constraint on firms in Africa. Many of Africa's firms are quite productive, and the question often is how to bring down indirect costs and losses to enable higher-value-added production and generate profits to feed into investment, fund growing, and higher pay for the workforce. In addition to providing quantitative evidence in firm surveys, firms also are providing useful qualitative feedback on the perceived severity of different constraints. The relative importance that firms place on physical infrastructure (in particular the cost and reliability of power supplies), finance, governance, regulation, and services can be of great use to policymakers who must decide what priority to give various interventions to improve the business environment.

Chapter 3 turns to another set of key issues—the patterns of ownership and capabilities in different groups of firms in African countries. Productivity analyses suggest that, in addition to the dampening effects of a poor business environment on all firms, many countries confront considerable segmentation between larger and smaller businesses and between more and less productive businesses. That segmentation often is related in a pronounced way with whether a business owner is domestic or foreign and with the ethnicity of the owner. The question is not why there are so few "black-owned" businesses. In all countries there are many such firms and indeed many highly successful ones that increasingly are investing outside their own countries. However, it is also often the case that bigger businesses, more productive firms, and export firms are still largely foreign owned or owned by ethnic minorities, whether Asian, Middle Eastern, or Caucasian. Why that is so is a complex question with a variety of explanations, including colonial history, the political and economic management of a country since colonialism, differential access to information and finance, and possibly commercial culture. Our data show, for example, that indigenous firms tend to start smaller and grow more slowly than minority-owned businesses and that different factors seem to influence their growth. We explore the reasons for this phenomenon in the broader context of the political economy of the private sector in Africa.

Why have low-income economies in Africa not undertaken more aggressive reforms? Certainly there are some notable successes, most recently, for example, in Rwanda, where the government has undertaken a series of reforms to improve the business environment. Yet business climate indicators reported in the World Bank's *Doing Business* rankings still lag in many African countries.[1] Some observers have noted a degree of ambivalence toward the market-based model of economic development in Africa and less follow-up on macroeconomic and trade reforms, which, in any event, are widely seen as having been imposed during the structural adjustment period rather than having resulted from countries' own efforts to secure access to markets abroad.[2] We consider some political economy explanations in chapter 4, including the implications for small countries of having sparse, fragmented business communities in which the indigenous sector is lagging.

These three issues—costs, the structure of the business community, and the process of reforming the business environment—are seen as interrelated. Without stronger business communities, including indigenous constituen-

1. World Bank (2001–07).
2. World Bank (2000).

cies, support for better business services and more stable and predictable policies will continue to be weak. At the same time, the creation of an effective lobby for broad pro-business reforms is constrained by unresponsive policies and poor implementation. *The central question is why the structure of the business environment looks the way it does.* What are the underlying factors constraining the performance of firms, and what policies will help address them?

Chapter 4 draws on the above analysis to suggest ways to encourage investment, focusing on solutions that have emerged from within Africa. There is no single binding constraint and no "silver bullet" to eliminate it, but the research and data that are becoming available on Africa's firms and business climate can help increase the possibility of accelerating regulatory and institutional reforms to complement improvements in infrastructure and macroeconomic management. We look for specific approaches to private sector development that we believe will make a difference for growth in the African private sector. Although the better information on the quality of regulation and business services now becoming available can be a powerful tool for accelerating reforms, that information needs to be integrated more systematically with reforms in other key areas of the business environment and into a structured dialogue between governments and private sector groups.