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Black Ownership of Businesses in Africa

There are many thousands of black-owned firms in Africa, but few of them are formal, registered firms and even fewer are medium-size or large businesses. The vast majority of black-owned firms are very small businesses with fewer than ten employees. Many of these firms can be described as informal, operating on the margins of the private sector with very little working capital or other resources. The formal business sector, on the other hand, is dominated by medium-size and large businesses, often owned by ethnic minorities. These firms produce the vast majority of value added. It is this phenomenon that we consider in this chapter.

Several similarities were found to exist among fourteen African countries in which questions regarding the ethnic identity of a firm were asked in a consistent way. Of the countries—Angola, Botswana, Burundi, the Democratic Republic of Congo, the Gambia, Guinea-Bissau, Guinea, Kenya, Mauritania, Namibia, Rwanda, Swaziland, Tanzania, and Uganda—most, if not all, had been colonized by European countries. Almost all pursued a post-independence industrialization strategy that focused on import substitution and the creation of a large state-owned sector. That in turn led to the emergence of an inefficient, dualistic manufacturing sector, in which a large number of informal and small firms coexisted with a few relatively large, capital-intensive businesses. Some countries, such as Tanzania, adopted socialist policies that sought to marginalize the business class; others, such as Angola, Burundi, and Uganda, experienced devastating civil wars or dictatorial rule that severely disrupted normal business development.

Most of the countries also adopted World Bank–initiated structural adjustment programs in the 1980s or 1990s to reform their economies and pursue outward-oriented growth. However, as discussed below, their manufacturing sectors remain small and fragmented—the majority of manufacturing remains under the control of either the state or ethnic minority groups, which account for much of the employment generation in non-extractive industries in the formal private sector. Understanding why black-owned firms in the formal private sector tend to be small is important because further broad-based growth of manufacturing can occur only with the participation of domestic businesses, including those of the indigenous majority.

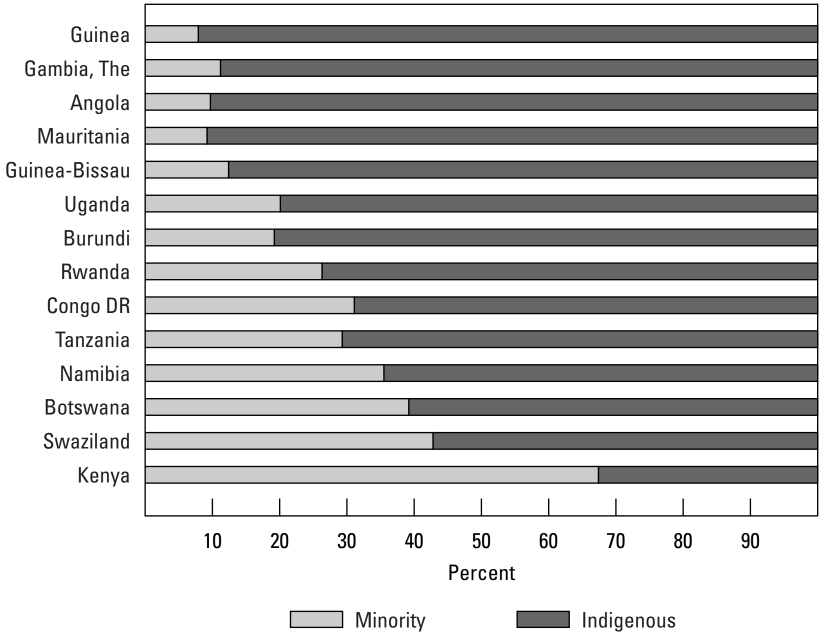
Indigenous and Minority-Owned Firms in the Formal Private Sector

The discussion that follows is based on survey data for the fourteen African countries in which questions regarding ethnic identity of the firm were asked consistently. We use the data to identify key characteristics of *indigenous* (black African–owned) firms in the formal private sector. It is important at this point to define "indigenous" and "minority-owned." "Indigenous" refers to firms that are black African–owned, including those that are run by owner-entrepreneurs, those with black African majority shareholders, and those that are owned by black Africans from a country in Africa other than the one in which the business is located. "Minority-owned" refers to firms that are owned by individuals or shareholders who are not black African but are African nationals of Asian, Caucasian, or Middle Eastern descent. Minority firms that are foreign-owned include firms whose owners are, for example, from Europe or Asia and who do not have African citizenship; foreign-owned minority firms also are included in our definition of "minority-owned."

The distribution of indigenous and minority-owned firms in our sample shows that many of the firms are in fact indigenous (figure 3-1), but we can also see that the relatively small share of minority-owned firms controls the vast majority of value added (figure 3-2). Except in three countries—Angola, Guinea-Bissau, and Swaziland—minority-owned firms control *50 percent or more* of value added in industry. In Guinea, Tanzania, and Kenya, they control more than 80 percent of value added.

The size distribution (as measured by number of employees) in our sample also is revealing. Figure 3-3, which gives the start-up and current size of

Figure 3-1. Distribution of Firms in Manufacturing, by Ethnicity[a]

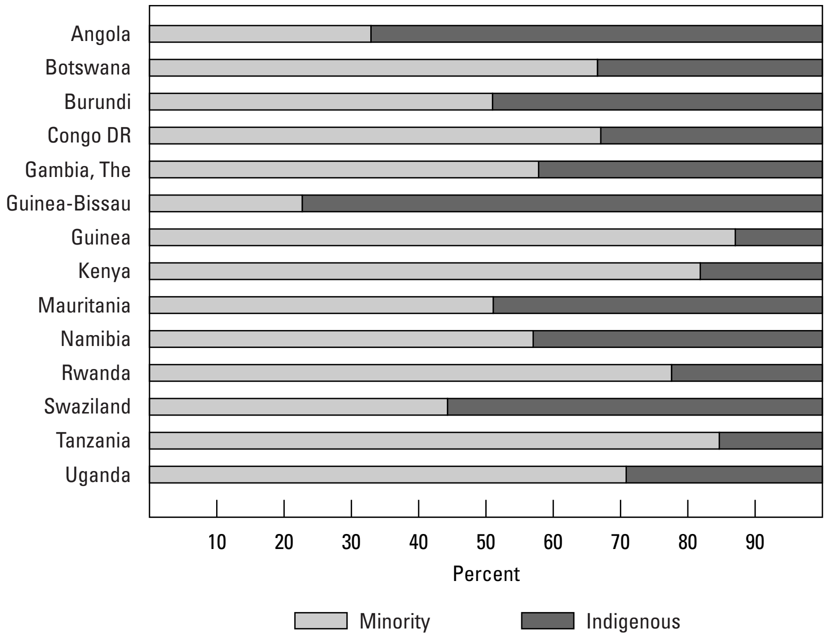


Source: World Bank Enterprise Surveys (www.enterprisesurveys.org).
a. Weighted frequency.

indigenous and minority-owned firms, shows that indigenous firms entered the market at significantly smaller sizes than minority-owned businesses. While the average firm size at start-up of minority-owned firms in Tanzania was about sixty employees, the number was just under twenty for indigenous businesses. For most countries, minority firms started at a size that was two to three times greater than that of indigenous businesses.

We also see that the difference in size persisted over time—size at the time of the survey did not differ much from size at start-up for indigenous businesses. In Uganda, for example, there was virtually no difference between the current size of indigenous firms and their size when they started—in other words, there had been virtually no growth. In some countries, a wide gap emerges over time between indigenous and minority entrepreneurs. Data on the age of firms surveyed (not reported here) show that minority-owned firms are not all that much older than indigenous businesses; therefore it is

Figure 3-2. Distribution of Value Added, by Ethnicity

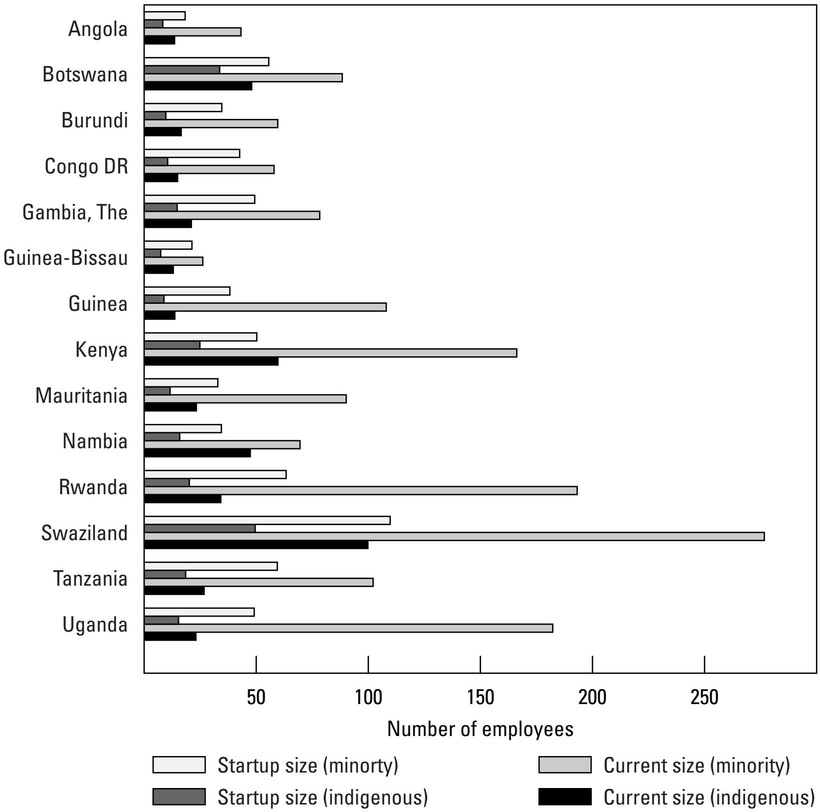


Source: World Bank Enterprise Surveys (www.enterprisesurveys.org).

not that they are bigger because they have been around longer. Over roughly the same period, minority firms were simply able to grow at a faster rate in many countries in Africa. The size differential between minority and indigenous firms at the time of survey was close to ten in Uganda, four in Tanzania, six in Rwanda, ten in Guinea, and almost five in Angola.

It is not easy to separate out the productivity effects of ownership because of the strong correlation with size. As seen in the previous chapter, larger firms tend to have higher productivity than small firms across the sample of countries surveyed. Larger firms are also far more likely to be minority owned. Size picks up much of the differential in capabilities, access to networks, and other factors that reflect ownership. Consequently, it is difficult to identify the impact of ownership on productivity. However, we are able to identify the differences in the growth rates of black-owned and minority firms and to investigate the reasons for those differences.

Figure 3-3. Start-up and Current Size of Indigenous and Minority-Owned Firms

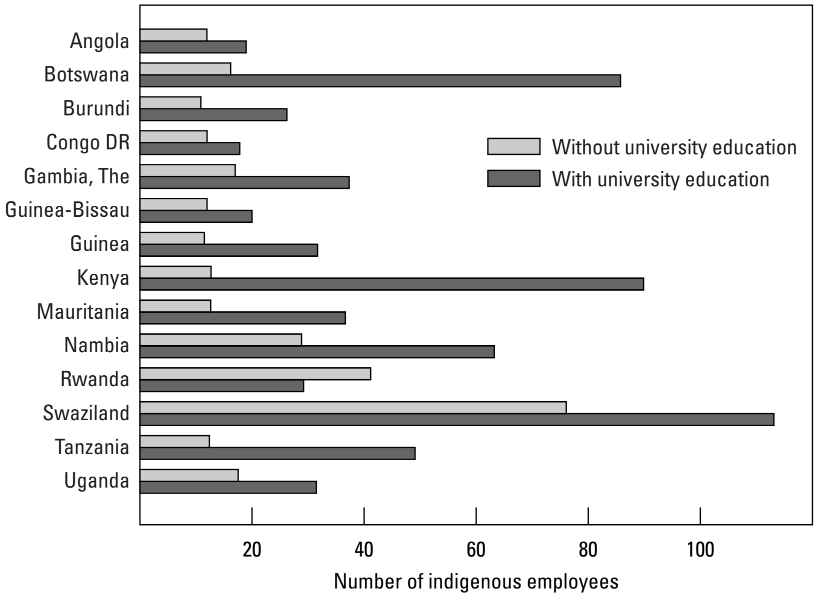


Source: World Bank Enterprise Surveys (www.enterprisesurveys.org).

Do some black-owned firms grow faster than others? Owners' attainment of a university education was very important in determining the size of the firm (figure 3-4). We also observe that indigenous entrepreneurs with a university education started much larger firms than those that did not have a university degree in almost all of the countries surveyed.[1] University education

1. There are other analyses of the role of ethnicity in the private sector in Africa. Most notable is Taye Mengistae (2001), which looks at the role of ethnicity in the indigenous private sector in Ethiopia. More recently, Fafchamps (2004) examines the dynamics of the private sector, including the role of ethnicity, in a comprehensive analysis of markets in sub-Saharan Africa.

Figure 3-4. Average Current Firm Size, by Education of the Owner



Source: World Bank Enterprise Surveys (www.enterprisesurveys.org).

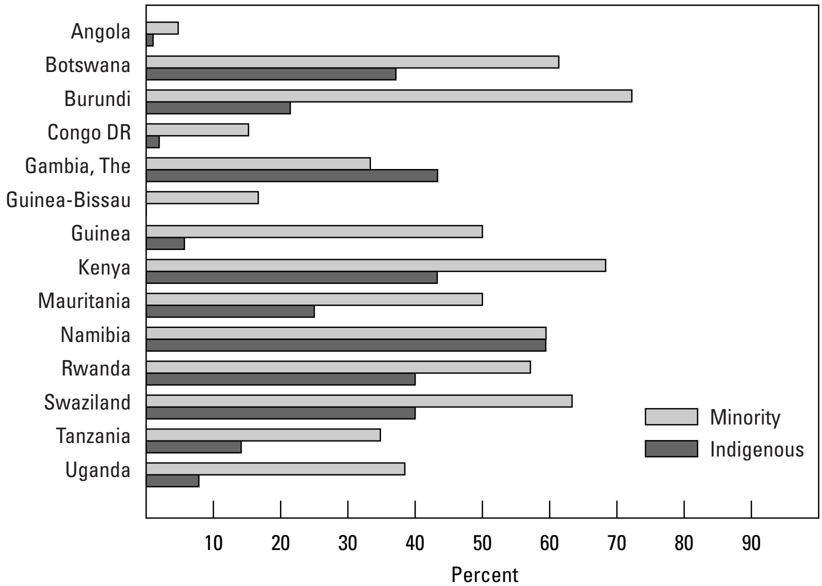
appears to be correlated with a larger size at start-up and a higher rate of growth for black-owned businesses.[2]

There are three possible interpretations of the finding regarding the impact of university education: a university education provides an owner with the tools to run a firm; completion of a university degree reflects greater ability on the part of an owner and consequently greater potential for success of a firm; and a university degree enables an owner to access a network of other professionals who provide information or facilitates access to credit. This finding is worthy of further investigation to indentify which of those factors is driving our results.

Do indigenous firms have less access to credit? That is the key question. Are they less likely to have bank accounts, overdraft protection, and loans? Is

2. Not reported here is the gap for minority firms according to educational attainment. This gap is much smaller; not being university-educated is less of a disadvantage for this group in starting and building a business.

Figure 3-5. Firms with Overdraft Protection, by Ethnicity



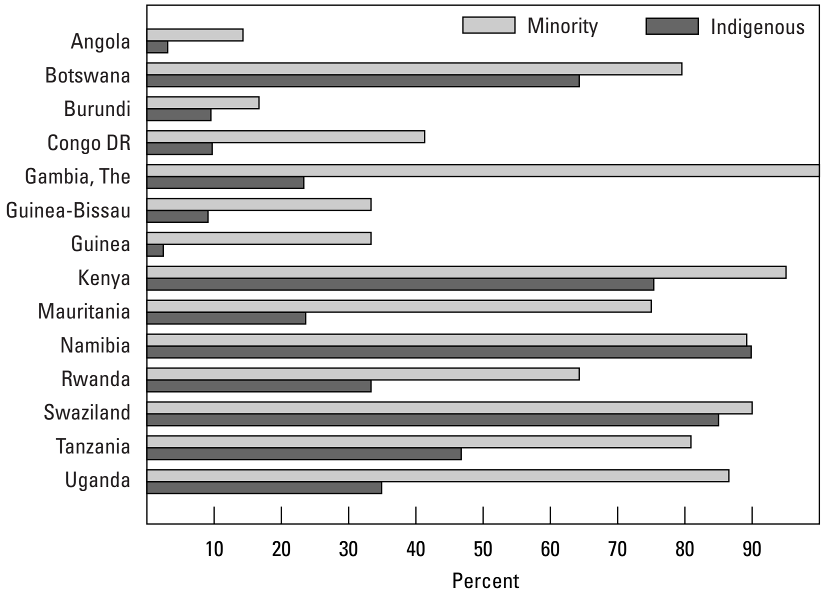
Source: World Bank Enterprise Surveys (www.enterprisesurveys.org).

access to the banking sector correlated with financial depth? Or are banks simply sorting firms according to their creditworthiness? In almost all the countries in our sample, we see that indigenous firms have less access to overdraft protection than minority-owned firms (figure 3-5).[3]

But the data also present evidence suggesting that the financial sector sorts firms to determine their creditworthiness. Figure 3-6 shows that there also are big differences in the percent of firms with audited accounts when disaggregated by ethnicity. Similarly, indigenous firms are less likely than minority-owned firms to own their business premises; consequently, they have less collateral with which to obtain financing (figure 3-7). These firms are less likely to be creditworthy and so have less access to finance.

3. Access to loans follows a pattern similar to that for overdrafts, but the differences across ethnicity are not pronounced. In fact, in countries such as Botswana, Namibia, Swaziland, and Namibia, *more* indigenous firms than minority firms use loans. It may well be that indigenous firms simply choose to use a different type of financing.

Figure 3-6. Firms with Audited Accounts, by Ethnicity



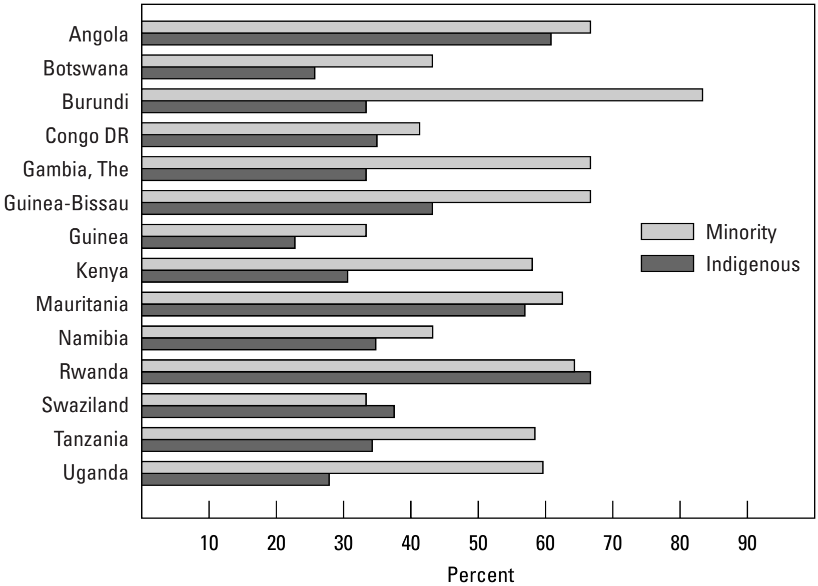
Source: World Bank Enterprise Surveys (www.enterprisesurveys.org).

Supplier Credit

Do indigenous firms have lower access to supplier credit? This type of credit enables the purchase of key inputs with a sixty- or ninety-day payment period. Figure 3-8 presents data on the percentage of firms using supplier credit. In all cases, indigenous firms have less access to supplier credit than do minority-owned firms.

Less access to supplier credit could be related to indigenous firms' age or to lack of a history of business transactions with suppliers—again, lenders may simply be sorting on the basis of creditworthiness rather than engaging in race discrimination. Figure 3-9 shows that firms that used trade credit did have longer relationships with their suppliers than those that did not use trade credit, except for firms in Botswana and Uganda. Overall, the evidence does not point strongly toward discrimination against black-owned firms but more toward the notion that banks do not lend to firms when they are unsure of being repaid.

Figure 3-7. Firms Owning Premises, by Ethnicity



Source: World Bank Enterprise Surveys (www.enterprisesurveys.org).

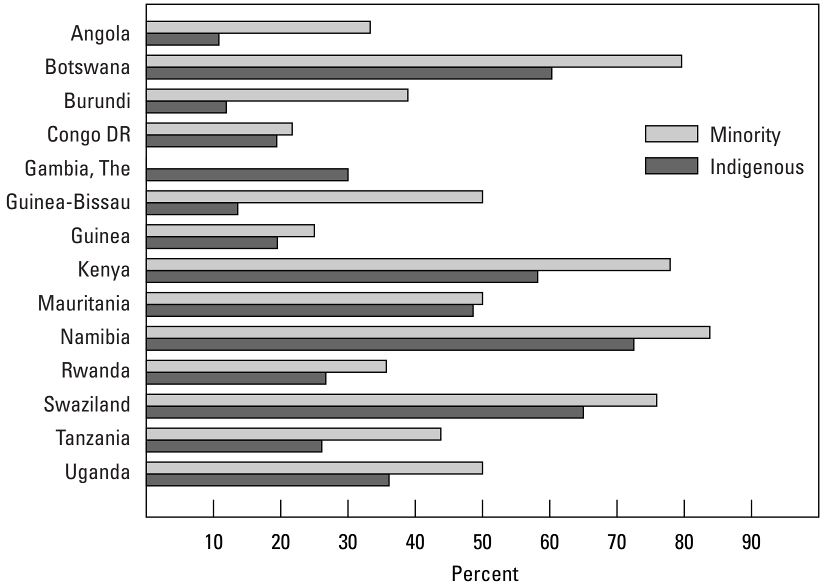
Determinants of Access to Credit

The descriptive statistics show that indigenous firms have less access to credit than minority firms in some types of financial products but not in others. Indigenous firms also are less creditworthy—they are less likely to have audited accounts and land that can be used as collateral for a loan. However, all of that could be because they generally are younger and smaller. It already has been established that indigenous firms own smaller firms. The banking sector and suppliers could simply be rationing out firms that are less established and that have a higher risk of failure.

We examine these hypotheses by running multivariate probit regressions with access to credit as the dependent variable. The results are presented in appendix 1, table A-2. In all cases, larger firms are much more likely to obtain credit than smaller businesses, ceteris paribus. Firm age is not significant in our estimations.

Indigenous firms also are less likely to have working capital finance such as overdraft protection and trade credit, and that remains true even after the

Figure 3-8. Firms Receiving Supplier Credit, by Ethnicity

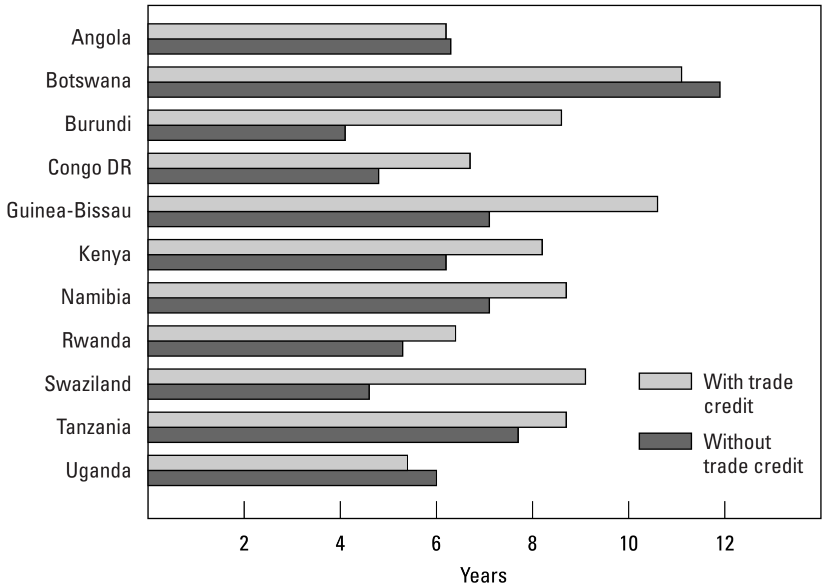


Source: World Bank Enterprise Surveys (www.enterprisesurveys.org).

analysis controls for size and age. However, they are more likely to have bank loans for investment. Having land to use as collateral matters—those owning land are much more likely to have bank loans and overdrafts than others. University education matters, too, particularly for indigenous businesses, for gaining access to working capital finance from banks; managers with higher education are more likely to have overdraft protection than owners without. Surprisingly though, education does not matter for having bank loans, perhaps indicating preferential treatment of indigenous entrepreneurs on the part of banks and other lending institutions.

Overall, our results present a mixed picture—indigenous firms may suffer from less access to credit in some situations, but other explanations also are possible. One is that the financial sector is likely to be sorting firms on the basis of creditworthiness. Another is that the need for credit may differ across firms, rather than access. Our results do point toward the need to establish credit registries and other means of evaluating firms rather than simply focusing on the expansion of the supply of credit.

Figure 3-9. Average Years of Relationship with Supplier, Indigenous Firms



Source: World Bank Enterprise Surveys (www.enterprisesurveys.org).

Why Are Indigenous Firms Lagging in Africa?

An important aspect of the success of firms is their ability to survive and grow. We formulate a simple econometric model that enables us to test hypotheses regarding the determinants of start-up size and firm growth. At this stage, our cross-sectional data do not allow us to develop an identification strategy that would lead to conclusive results on causality. But we can look at *correlations* between firm growth (as measured by number of employees) and variables such as age, size, and owner's educational attainment. We can do this for the entire sample as well as for indigenous and non-indigenous firms separately, as the appropriate statistical test (*F* test) allows us to break up the sample in this manner. In particular, we look at two key variables—access to overdraft protection and attainment of a university degree—to see whether they are correlated with start-up size and rate of growth. The results are presented in appendix 1, table A-3.

The first set of three regressions looks at the determinants of growth for the whole sample as well as for indigenous and non-indigenous businesses.

The first equation shows that after we control for several factors, indigenous firms have a lower rate of growth. We also see that although secondary education and vocational training are not significant, a university education is significant in determining a firm's growth rate. On disaggregating the sample, we see that the university education variables *are significant only for indigenous businesses*. It may be that university education imparts much-needed skills to operate a firm and to survive exogenous shocks or that it provides access to a network of business professionals who in turn provide access to knowledge, capital, and other inputs necessary for survival and growth.

It is also interesting to note that *indigenous firms of foreign origin* grow faster than those of local origin. In other words, a black African entrepreneur who has moved from Kenya to Tanzania is likely to build his or her firm faster than an entrepreneur operating in his or her own country. It may well be that a businessperson of African origin who can operate across national boundaries is more able or skilled than one who operates only within national borders.

Networks play a critical role in the African private sector. Our data show that the ethnicity of a business owner remains an important determinant of access to credit and a number of other performance variables, even when controls such as owner's education level and title to marketable assets are included in regressions. Usually within ethnic minority communities, networks help firms overcome the limitations of financial markets. At the same time, they effectively exclude outsiders from areas of business. Networks operate in many other regions, including fast-growing Asian countries, where they may have similarly positive effects in enabling their members to compensate for dysfunctional market institutions. But their overall impact is likely to be different in Asia and Africa, because of differences in economic density and market size. In Asia, their adverse effect in stifling competition is likely to be small because of the competitive pressure that results from having many firms that belong to many networks. However, in Africa's very small economies, the adverse effect of a few dominant networks or firms is likely to be far greater. Firms in sparse economies are likely to give more weight to the costs and risks of encouraging entry through reforms than are firms in dense economies.

Small, sparse industrial sectors dominated by a few, often ethnically segmented, firms with high market share are therefore likely to see less dynamic competition. The greater access of larger, networked firms to technology, credit, and business expertise creates rents that, even if shared with government, would be dissipated by more open entry. That can reduce the incentive to push hard for better regulation and business services. As discussed above, the segmented nature of many African business communities can complicate the process of developing effective means of communication between the business and government sectors to improve the business environment. At the same time, the prominent role of minority and expatriate firms increases the public's reservations over the market economy model, including large privatizations. The danger is a low-level equilibrium with high costs, limited pressure for reform from the business community and the public, and limited response from government.

Africa is not the only region where indigenous participation in larger-scale businesses lags behind that of some ethnic groups or foreign investors. Similar situations prevail in parts of Latin America, the Andean countries in particular, while concern in Malaysia over the level of indigenous participation in commercial agriculture and modern industry and commerce has been an important factor shaping policies there. Foreign investments in "sensitive" sectors have also been a matter of political controversy in the United States. In many African countries, firm surveys indicate that indigenous black-owned firms lag behind minority-owned firms and foreign-owned firms on a number of dimensions, including size and the rate of growth.

From the narrowly economic perspective, ownership patterns may not seem to be vital. But from the broader perspective of political economy, the issue is clearly of considerable concern. First, to the extent that ownership imbalances reflect inequitable barriers to participation, the economy loses the benefits of widespread access to opportunity. Second, as recognized in many countries, including Malaysia and South Africa, severe imbalances in the patterns of ownership and perceived wealth and power have the potential to encourage populist policies that can derail development. At best, ownership imbalances can generate a climate of mutual suspicion between government and a large part of the business community, which undermines the confidence to invest; at worst, such imbalances can lead to xenophobia and the expulsion of economically important minorities, with dire consequences for the economy as a whole. The domination of the business sector by a few large businesses, usually minority or expatriate owned, in countries with low economic density helps to sustain the ambivalent public attitude toward private sector–led development that has been noted, for example, in Afrobarometer surveys (Bratton, Mattes, and Gyimah-Boadi 2005). The danger lies in settling for a "low-level political equilibrium" with marginal reforms, leaving Africa falling further behind the rest of the world.

A clearer understanding of why indigenous firms often lag behind those owned by minority and foreign interests is therefore important in understanding the reasons behind the structure of business groups in Africa and the resulting political economy of reforms. We know that markets are thin and that the sparseness of economic activity results in the persistence of one dominant network in most countries. We also know that overall, the business environment is difficult, imposing high costs and risks on all businesses. Some may be better able to cope with certain difficulties than others. For example, in the face of unreliable power, larger firms with greater resources are more likely to be able to afford generators than smaller businesses. Certain large firms may also be more able to make special arrangements to protect themselves from predation. Yet at the same time, evidence from firm surveys suggests that often larger firms are also more vulnerable to failures in the business environment than small businesses. They transact over longer distances, are more dependent on sophisticated logistics, and are less able to operate under the radar of official scrutiny.

Overall, the evidence does not support the thesis that ownership imbalances are simply the result of an asymmetric business environment for indigenous and minority- and foreign-owned businesses, although social features of certain minority groups, in particular their ability to network to support "clusters" of related businesses, may assist them in overcoming some of the constraints of a poor business environment. The data support a more complex thesis—that the interaction of a high-cost business environment, a low-density economic environment, and the dominance of minority-owned businesses may underlie the absence of a broad-based private sector in many African countries.

Some Africa scholars argue that it is convenient to have a private sector that is dominated by ethnic minorities, who do not pose a significant threat to political power and often provide a steady stream of rents. The minority Asian community in East Africa, which has thrived even in difficult times, often coexists with a small, wealthy, indigenous private sector, and both are closely aligned with the president or his associates (Tangri 1999). The survival of this group depends on its political connections and rent-sharing arrangements with the government. The government in turn relies on it for extra-budgetary revenues. Other scholars reinforce this perspective, arguing that the political elite in Africa have found mechanisms by which to preserve rent-seeking arrangements with the help of a small private sector enclave (van de Walle 2001). When faced with donor country–driven reforms, governments often have reacted by accomplishing partial reform, thereby satisfying the rich countries, while preserving rent-seeking arrangements (van de Walle 2001). As a result, there has not been much change in the structure or competitiveness of the private sector. Indeed, reforms often have increased the level of uncertainty for the business community more than anything else.

On the whole, relatively little research has been done on the factors responsible for the imbalances in the business environment, and any conclusions on their causes are somewhat speculative. However, we present three possible explanations: culture and the ability to network, history, and risk diversification. We recognize that this is an area that requires further research.

Culture and the ability to network. Evidence suggests that many clusters of minority-owned firms belong to networks that usually are based on trust between members of a relatively small minority group and that can help firms overcome the limitations of a poor business environment (Fafchamps 2004). The data on access to finance do not suggest that black-owned firms are denied access to credit; instead, they indicate that firms of all races are sorted according to creditworthiness. However, Biggs and Shah (2006) show that the ethnicity of business proprietors remains an important determinant of access to credit and a number of other performance variables even when other dimensions, such as the education level of proprietors and title to marketable assets, are included as explanatory variables.

At the same time, networks effectively exclude outsiders from many areas of business. Networks operate in many other regions, including fast-growing Asian countries, but their overall impact is likely to be different in Asia and Africa because of differences in economic density and market size. In Asia, their stifling effect on competition is likely to be small because of the competitive pressure generated by having many firms belonging to many networks. However, in Africa's very small economies, the adverse effect of a few dominant networks or firms is likely to be far larger. Dominant firms in sparse economies are likely to give more weight to the risk that reforms may encourage entry than are firms in dense economies; as a result, they are less likely to lobby aggressively for reform.

Indigenous value systems do not always encourage investment, wealth-creation, and risk taking (Platteau and Hayami 1998). Some value systems embody a strong ethic of sharing, placing heavy obligations on successful members to share gains with other members of the group. Platteau and Hayami argue that in land-abundant societies (more likely to be in Africa), the sharing of assets and income other than land is more significant than in societies that are land-scarce (in Asia). They pose detailed theories on how resources are shared and how people who do not conform to social norms are punished. They also discuss attitudes toward wealth and argue that many African societies stress egalitarianism over the accumulation of wealth by individuals. Other researchers argue that norms regarding wealth sharing may lead to a disincentive to migrate from a village to a town to become an urban worker or entrepreneur. Kinship, they argue, can be viewed as a poverty trap (Hoff and Sen 2006).

History. During the colonial period and at independence, most larger-scale agriculture, industry, and commerce were in the hands of minority and expatriate investors. One of the consequences, in many countries, was a wave of indigenization and nationalization that was reversed in the course of the 1990s. Few countries, therefore, have grown strong indigenous business communities that are accustomed to operating in a competitive market environment.

Risk diversification. Firm surveys find that higher education of the owner is one of the predictors of business success for indigenous businesses but that relatively few owners and managers of indigenous firms have had access to higher education. Faced with highly unstable and uncertain politics and economies, many of Africa's educated elite have migrated outside the region (Ndulu and O'Connell 2006).

In contrast, investment in Africa's economies by minorities and foreign investors often is part of an investor's multicountry investment and risk-diversification strategy. Increasingly, these investors include black investors from other African countries and sometimes black Africans who have immigrated to other countries. Survey results suggest that firms owned by such investors are little different from those owned by other foreign investors. This supports the view that the issue is not race per se; it is instead the range of opportunities and capabilities possessed by different groups and the impact of culture in helping firms surmount some of the difficulties posed by the business environment.