Center for Global Development

CGD Brief

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Africa's Private Sector:

What's Wrong with the Business Environment and What to Do About It*

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Listening for Solutions

Why has the private sector failed to thrive in much of sub-Saharan Africa? Drawing on a unique set of enterprise surveys, we identify inadequate infrastructure (especially unreliable electricity and poor quality roads) and burdensome regulations as the biggest obstacles to doing business. We find as well that the private sector in many countries is dominated by ethnic minorities, which inhibits competition and lowers demand for a better business environment. Solutions include investing in infrastructure, providing risk guarantees, and reforming regulations to lower the cost of doing business, as well as increasing access to education for would-be entrepreneurs.

Introduction

Our analysis starts with a single question: why is business performance lagging in Africa? We utilize the results of Enterprise Surveys from sub-Saharan Africa and elsewhere to concentrate on what managers and entrepreneurs in the African private sector are telling us about their day-to-day problems. We focus on businesses in the formal manufacturing sector, which may not be the dominant economic sector but is vital to the economic development of the continent.

A productive business environment would encourage growth, learning, investment, and competition on a global scale, whereas an environment of high costs and risks would discourage would-be entrepreneurs from establishing a business, investing in it, and increasing its productivity. Where does the African business environment stand?

To answer that question, we also have to consider the capabilities and capacities of businesspeople themselves. Are they able to take advantage of the opportunities of an increasingly open and globalizing Africa? If so, which owners, managers, and entrepreneurs have access to opportunities and which have less? Are there major differences between indigenous and foreign-owned businesses, for instance, or majority-owned businesses and those owned by ethnic minorities? If so, what might that mean for the political economy of business-government relations? We address these questions and identify the policy solutions to help African business clear its hurdles and succeed.

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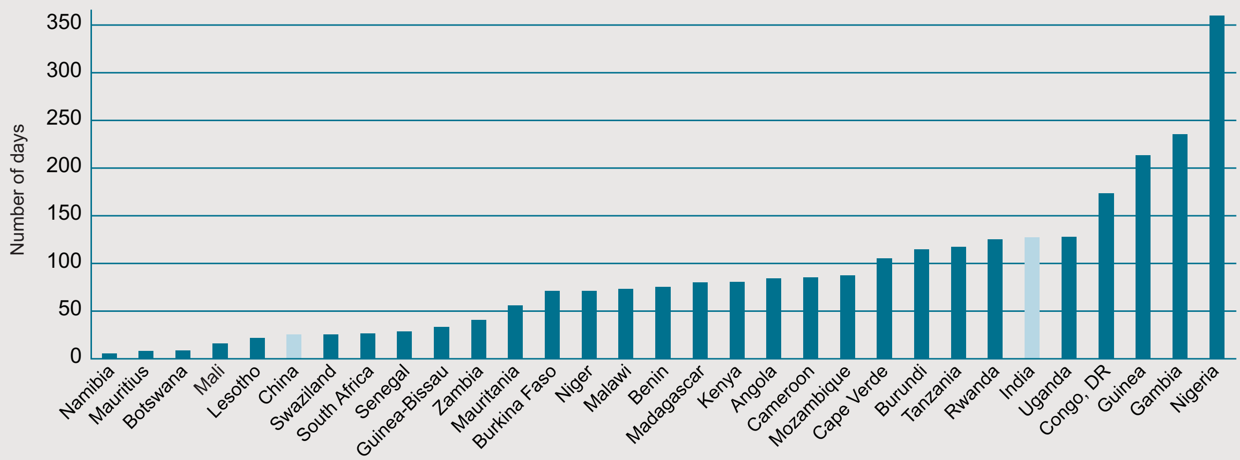
Figure 1. Number of Days Per Year with Power Outages



"No Electricity Presently Available"

Across Africa, a majority of businesses surveyed cite inadequate power supply as a major or severe constraint. Outages are not just frequent but unpredictable and long, sometimes stretching through the entire work day. Businesses in many countries suffer outages on more than half the working days in the year (see Figure 1). Comparable data for China show that the burden of power outages for businesses there is far smaller.

Perhaps no country in Africa is affected more than Nigeria. Almost 40 percent of electricity there is privately provided by generators, and businesses report that outages occur almost every day of the year. Almost all businesses own generators of varying quality and vintage to compensate for the extraordinarily unreliable supply from the Nigerian Electric Power Authority (NEPA—often referred to by the citizenry as "No Electricity Presently Available"). At the same time, fuel is sometimes hard to find in this oil-exporting country, and maintenance of generator equipment imposes further costs on business owners.

Roads Are Almost As Bad

The low-income economies of sub-Saharan Africa have far fewer miles of paved roads and fewer modern freight- and passenger-transport systems than any other region. Inadequate infrastructure restricts businesses to fragmented regional markets or to opportunities with profits large enough to cover high transportation costs. Businesses that try to supply markets beyond their immediate vicinity can lose nearly 6 percent of the value of their consignment to transport costs. The ill effects of bad infrastructure are difficult to reverse because, unlike the power supply which can improve or deteriorate rapidly, transport bottlenecks are typically long-term—bad roads and limited transnational linkages have kept markets and businesses highly segmented for decades. As a result, African businesses are far less productive than Chinese businesses when "indirect costs" such as electricity and transportation are accounted for. And high infrastructure costs are also likely to reduce the entry of new businesses into the private sector.

Entrepreneurial Capacity

The private sectors of many African countries are ethnically segmented or dominated by ethnic minorities, or both. Segmented networks in already sparse economic environments limit competition, encourage an ambivalent attitude toward facilitating a good business environment, and constrain the growth of businesses outside the dominant network. Large markets may compensate for ethnic segmentation by encouraging entry or sustaining multiple networks, but these mitigating effects are not in play in much of Africa. In many countries, we have yet to see the emergence of a broad-based business class.

A Tale of Two Bakeries

A bakery in Uganda that employs 39 workers suffered power outages on 120 days in 2007. The owner estimates the bakery loses about 10 percent of its sales because of power outages. Annual productivity, as measured by value added per worker, is around $2,000. Meanwhile, a similar bakery in South Africa is almost six times as productive and has value added per worker of $11,000. This bakery suffered virtually no power outages and did not lose any sales due to poor-quality infrastructure.

Solutions

Several reforms are potentially important and can reinforce each other:

- Opening borders would encourage conglomeration and increase the scale of markets and the density of economic activity
- Improvements in infrastructure, especially power and roads, would lessen the cost burden on African businesses
- Introducing service guarantees could improve the responsiveness of governments to the service needs of businesses
- Strengthening the private-public dialogue and support for homegrown efforts such as the Investment Climate Facility for Africa would help broaden the base of the private sector

As Africa resolves its power problems, its conventional energy investments will continue to be vital to sustain growth. But the continent has a unique opportunity to lead the world by becoming a producer (and even an exporter) of clean renewable energy. African reserves of renewable resources—solar, wind, hydro, and biofuel—are the highest in the world and greatly exceed current consumption. Small-scale power installations, such as micro-hydro schemes or rooftop solar panels, are well suited to a continent where traditional grid-based electricity will likely never be cheap, reliable, or far-reaching. And because many private businesses can supply such installations, there can be less need for extensive government regulation.

As with power, African countries should look regionally for a transportation strategy. A network of roads connecting all sub-Saharan capitals and other cities with populations over 500,000 would result in an expansion of overland trade of about $250 billion over fifteen years, with both direct and indirect benefits for Africa's rural poor (Buys, Deichmann, and Wheeler 2006). Best-practice models of maintenance and the rise of a technocratic class of public servants in many African countries increase the feasibility of good solutions to these problems.

What can be done to improve entrepreneurial capacity? One essential component of policy is investments in higher education, whether it comes through formal educational institutions or some other type of training directly related to business-specific skills. Enhancing local capacity to provide such training should be an important objective. Outside South Africa, African business schools are generally much in need of skills enhancement and curriculum development. Initiatives such as the Global Business School Network, which seeks to build the capacity of selected African business schools by bringing them together with leading business schools in industrial countries, are helping to fill the gap.

Another option to encourage domestic investors could be to make available more broadly some of the programs that have been used to encourage foreign investment. Partial risk guarantees from the World Bank and the International Development Association have been used for the last decade to facilitate private investment in large infrastructure projects. Partial risk guarantees could also be broadened to include "service guarantees," which could be made available to domestic and foreign investors on an equal basis.

Under such an approach, countries implementing reforms in key areas such as power, customs, licensing, and so on, would commit themselves to service standards. Businesses could purchase insurance against service failures, perhaps not on an individual basis but on the basis of overall performance. These contracts would be underwritten by risk-guarantee programs, possibly funded by donor countries through programs of the international financial institutions. Widespread or persistent failure to provide business services to accepted standards would then activate the guarantee. This would do more than just compensate businesses for lost revenues; it would force policymakers to make discussing business service standards a high priority.

Further Readings

Piet Buys, Uwe Deichmann, and David Wheeler. 2006. "Road Network Upgrading and Overland Trade Expansion in Sub-Saharan Africa." Policy Research Working Paper 4097. Washington, D.C.: World Bank.

Benn Eifert, Alan Gelb, and Vijaya Ramachandran. 2008. "The Cost of Doing Business in Africa: Evidence from Enterprise Survey Data." *World Development* 36(9): 1531–1546.

Todd Moss. 2007. *African Development: Making Sense of the Issues and Actors*. Boulder, CO: Lynne Rienner Publishers.

Enterprise Surveys website, www.enterprisesurveys.org

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