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Impact of Investment Climate Reforms on Growth and Development of SMES: Comparisons from South Africa, Nigeria and Cameroon

By

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INTRODUCTION

Drawing from World Bank Investment Climate surveys, the main objective of Investment Climate Assessment (ICA) studies is to develop a better understanding of the constraints to investment and sustained productivity growth in a given country.

African economies currently stand as among the fastest growing economies in the world. Despite the perceived growth, Africa still lags behind fellow developing economies in a number of development parameters, including the contribution of the private sector and the growth of its economies.

With the celebrated role of Small and Medium Sized Enterprises (SMEs) as important private sector players in creating employment and enhancing economic growth, national governments across the globe have initiated a range of policies and programmes to promote their growth and expansion.

In the recent past, Sub-Saharan African countries have started paying attention to SMEs as key drivers of the economy, mostly taking cue from East Asian economies where SMEs have played a major role in propelling the economies to their current status as global economic giants. However, limited studies have been done to assess how policies and programmes, put in place by African economies, have progressed.

There are no studies that compare the challenges affecting the growth and expansion of SMEs in Sub-Saharan Africa.

The challenges that SMEs face are often a reflection on the investment climate, and whether reforms have succeeded in creating a conducive environment for their growth and development.

This policy brief summarizes the study's key findings and gives a clear understanding of the business environment in which SMEs operate. It also details the impact of government support policies in enhancing their contribution to economic growth in three African economies.

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Sampled countries include South Africa in the South African Development Community (SADC) region, Nigeria in the Economic Community of West African States (ECOWAS) region and Cameroon in the Economic and Monetary Community of Central Africa (CEMAC) region.

Representing the largest economies in their respective regions, it was perceived that assessing the business climate and challenges facing the business sector in the chosen countries will reflect the broader picture of the region. This is crucial in informing national and regional policy.

With increased emphasis on the potential of SMEs in supporting the public sector, numerous studies have been undertaken to identify the challenges facing the private sector in general and how policies to support entrepreneurial growth can be improved. Based on the findings, broad conclusions and policy recommendations have been proposed to enhance the business climate in the case study countries.

> **There is need for government policy to support the development of a vibrant agricultural sector, one which is able to initiate the transformation of primary unprocessed agricultural products to semi-processed goods exported around world markets.**

RESEARCH OBJECTIVES AND METHODOLOGY

The key objectives of the study were to:

1. Investigate government policies and support programmes implemented towards reforming the investment climate in Cameroon, Nigeria and South Africa in the last twenty years.

2. Using a quantitative instrument, investigate the extent to which government policies aimed at improving the investment climate (policies concerning tax, regulation and their application) have encouraged or discouraged the emergence and growth of SMEs in each of these countries.

3. Analyse the data collected and document the major challenges affecting the business environment for investment climate in the three countries.

4. Propose policy recommendations on how to improve government support policies and programmes, which impact start-ups and growth of SMEs.

In order to meet the stated objectives, a range of methodological approaches were adopted, each suited to the research question at hand. The approach relied generally on a desktop review of literature and policy documents on SMEs in the three case study countries. This was aimed at identifying key policies and programmes targeting the support of SMEs growth.

At a micro-level, data collection and analysis relied on a survey of 1,200 firms in the three countries. Using 400 firms per country, the survey aimed at extracting primary information of interest to the research questions.

In Cameroon, 400 firms were sampled in four provinces (100 firms from each province), while in Nigeria 100 firms were sampled in Port Harcourt, and Abuja with the remaining 200 in Lagos.

In South Africa, half of the surveyed firms were in Gauteng. The remaining 200 were shared between the Free State and Western Cape provinces. The survey targeted firms and entrepreneurs, seeking their perspective on the benefits derived from government support programmes, as well as the challenges faced within their business environment.

Using open-ended interviews, researchers approached managers of business support services and programmes to better understand the process in supporting SMEs. Quantitative data was analysed using SPSS and Excel, and presented in three separate reports. In the reporting process, qualitative data collected through interviews was incorporated in the final reports.

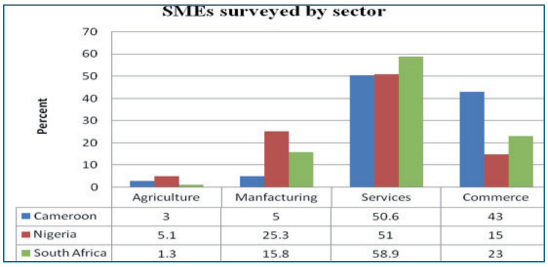
KEY FINDINGS

Key findings from the survey have been classified in two categories based on the objectives and research questions.

Characteristics of the Business Sector

From the statistical description of the data, it was observed that more SMEs operate in the service and commerce sector. As observed in Figure 1, more than half of the SMEs surveyed were in the service sector, followed by commerce, and then agriculture related activities (with less than 10 percent of all surveyed firms). While the shift from primary to secondary and tertiary business is important for any economy, the high dependence on agriculture by most African economies demand support through improved, innovative and advanced agricultural practices.

Figure 1: SMEs Distribution by Sector.



Source: Samuel Fongwa and Gabila Nubong

In Cameroon, for example, there is need for government policy to support the development of a vibrant agricultural sector, one which is able to initiate the transformation of primary unprocessed agricultural products to semi-processed goods exported around world markets.

With this transformation, governments would increase revenues and improve manufacturing and commerce sectors.

Another interesting characteristic of the firms surveyed in all three countries is that more than 75 percent of all employees were not members of any form of trade or labour union. This could be indicative of very limited networking and potential collaboration between SMEs in similar business sectors. This could make for unhealthy business practices as identified by previous ICA studies.

Another characteristic in the three countries is a significantly low level of exports. In the three countries, less than ten percent of all products are marketed to international markets. Sixty-five percent of SMEs sell their products in local or provincial markets. Bigsten and Söderbom (2005: 35) contend that "... to create incentives for African firms to strive to participate and be competitive in international markets ... is the most likely route to better economic performance."

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Major Obstacles Affecting the Business Climate

On the major challenges affecting the business climate, analysis revealed that cost of finance and access to finance remain significant challenges in all three countries. In Nigeria, electricity was identified as a severe obstacle to business operation. This is characterised by infrequent power cuts and high prices.

Corruption was also identified by 50.8 percent of respondents as a second major challenge to doing business as SMEs. In South Africa, cost of finance and crime featured as the top challenges to the business sector. Firms in the Gauteng province further identified corruption and transportation as other major challenges. In the Western Cape, firms identified lack of business support as another typical challenge.

In Cameroon, more than 70 percent of all firms surveyed identified the tax regime as the most severe challenge affecting the business environment. This was followed by lack of business support and access to finance.

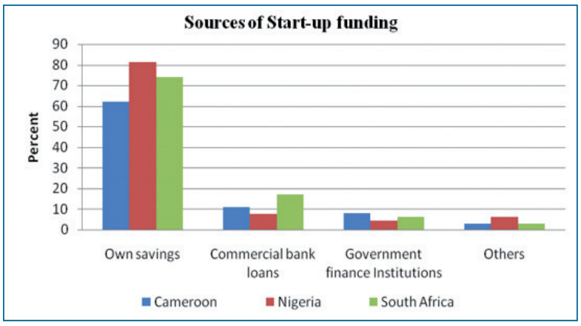
The above finding on access to finance and credit is reflected in the following argument on a study on the South African business climate: "objective measures of financing provide some support for the idea that access to credit is more difficult for African-owned firms. African-owned firms were less likely to have ever applied for a loan, were less likely to have a loan, were less likely to have an overdraft facility, were more likely to have been rejected for a loan, and paid higher interest rates on their loans" (Clarke et al. 2006).

On sources of expansion finance, data from the firms reveals that SMEs have hardly benefited from the financial support from government support programmes, nor commercial banks.

Interviewed on the sources of start-up and growth finance, a majority of the firms indicated that their sources of funding were from personal savings and commercial bank loans. This supports findings from previous research (Martinez Peria 2009; Dti 2003), which indicates access to finance has been a major factor affecting business growth and development in the continent.

Martinez Peria (2009) further argues that loans for SMEs in Africa are far more costly than in other developing countries. For instance, it was found that banks in Africa charge on average almost 15.6 percent for loans, while interest rates in other developing countries hardly exceed 11 percent. This makes access to commercial bank loans difficult. With the numerous challenges in gaining access to finance, SMEs are not able to introduce innovative improvements to products and processes which negatively impacts on their ability to take advantage of new market opportunities (Soni 2005).

Figure 2: Sources of Start-up Funding



Source: Samuel Fongwa and Gabila Nubong

The governments in the three countries have recognised the important role played by SMEs in promoting economic growth. This recognition has been manifested in the establishment of various policies and programmes to support SMEs start-up and growth. In South Africa, both financial and non-financial support initiatives have been established.

Access to Business Support Programmes

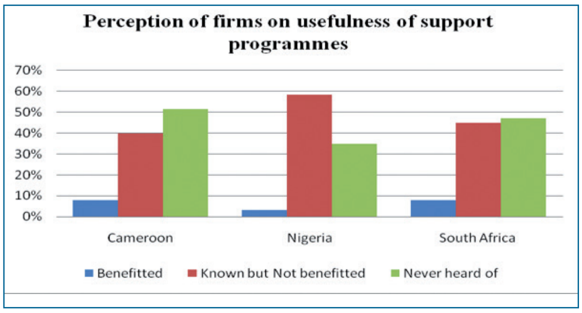
The research examined an important aspect of how firms accessed business support programmes initiated by local, provincial, federal or national governments. Figure 3 represents data from five major government initiated support programmes.

In South Africa, the programmes include the Small Enterprise Development Agency (SEDA), Khula Enterprise finance, Ntsika, BESD, and the National Youth Development Agency (NYDA). It should be noted here that the DTI programme was not surveyed in all three provinces, thus it was not included in the summary.

> **In Cameroon, more than 70 percent of all firms surveyed identified the tax regime as the most severe challenge affecting the business environment.**

In Nigeria, there are several support programmes, including the Small- and Medium-Scaled Business Development Agency of Nigeria (SMEDAN), the Nigerian Development Bank (NIDB), IDC, CMD and CIRD. In Cameroon, the National Investment Corporation (SNI), National Employment Fund (NEF), GICAM, and others are programmes to support SMEs.

Figure 3: SMEs' Perceptions of Support Programmes



Source: Samuel Fongwa and Gabila Nubong

From the Figure 3, less than ten percent of all surveyed firms have benefitted from government support programmes. In Cameroon, the most beneficial programmes are the SNI and the NEF.

In Nigeria, SMEDAN, and NIDB were the most useful programmes, while in South Africa, the

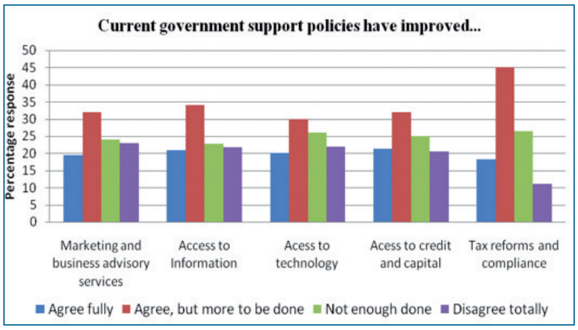
SEDA and NYDA have been most beneficial to entrepreneurs. According to surveyed firms, the majority of the support programmes have failed to provide the expected benefits to business start-ups and growth. This could be due to the different level of sensitisation carried out by the respective government.

In South Africa, SEDA has been the most publicised government policy and structure available to SMEs. Similarly, in Cameroon the NEF has been the most accessible structure for emerging entrepreneurs. What this tries to explain is that, as seen in the green bars on the chart, about half of all firms surveyed have not heard about government support programmes. There is limited access to relevant information for firms.

SME Perception of Government Policies

Asked about the perception of the impact of current government policies and their effect on the business climate, more than half of respondents agree to some extent that government policies have not provided the intended benefits. More than half of the surveyed SMEs expect more from government policies. In Nigeria, less than 5 percent of all sampled firms fully agree with the current government policies, while in Cameroon the average figure is less than ten percent.

Figure 4: Firms Perceptions of Government Policies in South Africa

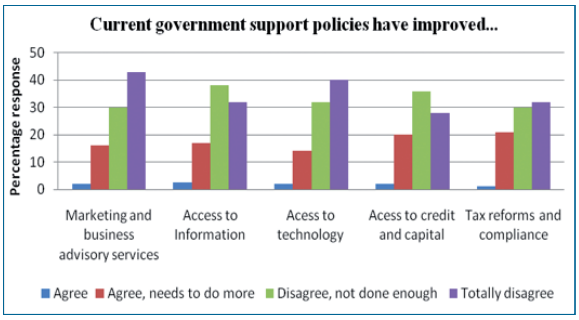


Source: Samuel Fongwa and Gabila Nubong

From the Figure 4, it can be observed that South African companies surveyed feel that current government policies are providing more support for the business environment. The data reveals that tax reform policies remain one of the policy areas needing improvement.

Figure 5 depicts a situation of near total disagreement by SMEs in Nigeria with current government support programmes. Less than 25 percent of all firms sampled agree that they have benefitted from government programmes.

Figure 5: SMEs' Perceptions of Government Policies in Nigeria



Source: Samuel Fongwa and Gabila Nubong

The situation in Nigeria could be related to the low levels of sensitisation, and local firms being more aware of current government policies. This can also be attributed to the initiation of policies not informed by the real market environment. Based on the fact that more than 80 percent of the firms are sole proprietorships, and that there is a significant lack of trade union membership by employees, it can be further argued that there is a lack of coordination between the national government, local government and local firms.

CONCLUSION AND POLICY IMPLICATIONS

The findings show that SMEs in all three countries, just as in other parts of the continent, are affected by several challenges facing the business climate. However, while firms face most of these challenges across the African economic region, there exist country-specific aspects, which demand context-specific policies to address particular challenges in the private sector.

The research findings reveal that Africa is increasingly recognising the important role of the private sector in supporting economic growth through inter alia job creation, and tax revenues. From the policy documents reviewed, it was observed that the governments in the three countries have enacted policies and developed programmes to enhance SMEs start-up and growth.

These programmes include financial and non-financial support at national, provincial or local levels. However, from empirical studies, these programmes have failed to meet the purposes for which they were established. The findings further reveal that there was not a high level of awareness related to various programmes. If SMEs are expected to contribute to GDP and economic growth, policy makers must return to the drawing board to adequately address the challenges facing SMEs.

There is therefore a great need to increase awareness of government support programmes and access to relevant market information. A study by the Economic Commission for Africa reveals that access to quality credit information in sub-Saharan Africa is generally low. On an index from zero to six, the average SSA scores an average of 1.5. Seven countries exceed the average with South Africa providing the best quality credit information, followed by Namibia, Swaziland, Botswana, Egypt, Kenya and Tunisia all having scores of above four points (ECA 2008). This implies Nigeria and Cameroon need a policy and practical drive to improve quality of credit information to SMEs.

It has been observed from previous research that there is a lack of adequate consultation between government and businesses when policies are established to improve business development. As argued by Kaufmann et al (2006), programmes for SMEs should be developed in partnership with firms and businesses, so that firms have a voice in these policies and hence enhance their participation in the implementation of the support policies.

This will also ensure more inclusive policy formulation, taking cognisance of all stakeholders in the private sector. The high lack of awareness of government policies by firms in the three countries is an indication of a divide.

Looking at government policies aimed at easing business activity in the three countries, it is important that the Nigerian and Cameroon business policy sectors examine and emulate best practices from South Africa and other performing economies. With South African firms providing a high rate on the benefits derived for government policies, it becomes important to commission a study on the South African policy system, as well as best practices in the context of Cameroon and Nigeria.

Conclusively, it has been argued from NEPAD studies that good governance remains a fundamental aspect in creating an enabling business climate. While South Africa has enjoyed a relatively stable governance structure over the past decade or so, Nigeria and Cameroon have been plagued by political unrest. Therefore, both governments should address political governance issues. According to Transparency International, Cameroon and Nigeria have experienced high levels of corruption and mismanagement. This creates high investment risk and hampers economic growth (UNIDO).

> **If SMEs are expected to contribute to GDP and economic growth, policy makers must return to the drawing board to adequately address the challenges facing SMEs.**

SMEs hold a huge promise for Sub-Saharan Africa's growth and development. For this growth to be achieved, the climate of investment must be addressed and improved for start-ups and subsequent growth. While policies and structures are being implemented by many African economies, this study has shown that more is yet to be done. South Africa appears to be on an ascending side of the slope, while economies in West and Central Africa seem to be plagued by challenges on different fronts and require urgent policy development and implementation.

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