

## Research Paper

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# Developing Businesses of Scale in Sub-Saharan Africa

## Insights from Nigeria, Tanzania, Uganda and Zambia



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# Contents

	Summary	2
1	Introduction	4
2	Nigeria	9
3	Tanzania	17
4	Uganda	25
5	Zambia	33
6	Conclusions	39
	About the Authors	44
	Acknowledgments	44

## Summary

- This paper presents a snapshot of the business environment in Nigeria, Tanzania, Uganda and Zambia, from the perspective of the owners and managers of over 60 businesses interviewed as part of the research phase. It is also an analysis of the constraints facing, and opportunities for, company growth in these countries. Although there are some common factors between them, the four countries have very different political economies, and for this reason the picture that emerges is diverse.
- The population of sub-Saharan Africa, currently exceeding 1 billion, is projected to more than double by 2050. In order to reap the benefits of this ‘youth bulge’, the labour pool needs to have access to jobs. The continent’s economic performance, in terms of growth in GDP per head, is less than half that of South Asia, while Africa has over twice the level of unemployment. Mass unemployment can lead to political instability and keeps country tax bases low, making investments in improving the business climate more difficult. In line with the UN Sustainable Development Goals, specifically Goal 8 concerning targets for growth in formal employment and higher productivity, all four countries studied in this paper grapple with the challenge of creating an effective enabling environment for local businesses to grow and thus to provide more and better formal jobs.
- There is no single solution for scaling up small and medium-sized enterprises (SMEs) in Africa. The political economies of African states and sub-regions preclude easy generalizations. A primary conclusion is that any attempt to finance or stimulate business growth must be shaped by a deep understanding of the specific national and regional context. But there are a number of common constraints to business across Nigeria, Tanzania, Uganda and Zambia, particularly limited access to mid-scale finance for SMEs, a lack of capable managers, poor infrastructure – especially electricity and roads – a constrained pool of skilled workers, and corruption.
- There is enormous entrepreneurial energy in each of the four countries surveyed, as well as huge potential and an increasingly acute need for job creation. Enabling local businesses to reach scale constitutes a significant opportunity for investors and an essential part of the transformation of Africa’s economies. Governments in all four countries have recognized the need to expand and diversify local businesses, and are pushing forward with investments in infrastructure and improvements in the business environment. But the core constraints remain pervasive.
- Improved infrastructure makes a difference, but is not a panacea. For example, Uganda has improved its basic infrastructure, but business has not yet expanded in proportion to these improvements. Across the four countries, even where roads are good, roadblocks and customs posts can add significantly to transport costs. Extending electricity grids potentially has a major role to play in boosting productivity and the expansion of firms, and therefore in indirect job creation, but many citizens cannot afford to access available supply.

- Banks and lenders need strategic patience in order to be catalysts for business expansion. Growing a business can take many years, but too many banks operate on a model of issuing short-term, high-interest loans. This is particularly the case in the context of economies and populations that remain heavily dependent on small-scale agriculture and a large informal sector: many SMEs are seen as risky propositions by commercial lenders. Banks compete for mass-market savings and appear keen to extend mobile banking, but this is not matched by dynamism in lending to SMEs.
- Improving education and workers' skills are vital. In all four countries, the lack of skilled labour and management is identified as an important barrier to scaling up. The youth bulge is not being matched by an increase in skilled human capital for businesses to draw on.
- These constraints are particularly acute in terms of developing agricultural businesses, which are still the mainstay of economies across the four countries. Trapped in patterns of smallholder production, isolated by infrastructural deficits in transport and storage, dependent on natural inputs and with weak patterns of formal land-holdings, SMEs working in agricultural production and processing are risky propositions for lenders, and offer low yields for investors. Governments have recognized the imperative of developing agriculture, notably to provide mass employment for booming populations, but significant policy challenges remain.
- Government policies and practices as well as patronage politics remain common deterrents for business growth, and contribute to keeping many businesses informal and small-scale. Resources such as the World Bank's annual 'doing business' rankings are useful indicators across the countries assessed, but they reflect the formal content of regulations rather than their implementation on the ground – and can thus gloss over the realities of the political economy. Some of the most creative business innovation has been in working around the state, rather than with it. Pro-business policies are often superficial, while real political will to enforce regulations or to simplify and streamline taxation is scarce.
- There are significant opportunities for those with access to private capital, as well as for foreign-owned and -managed firms. Many are flourishing. But even if these firms are able to provide large numbers of jobs, they still run the risk of real and perceived inequalities, between locals and expatriates, or between those with access to urban markets, advanced education or political connections. Getting companies to scale up is critical, but ensuring that local entrepreneurs from all walks of life are able to compete – by supporting access and improvements in local supply chains, for example – is also key.

# 1. Introduction

Sub-Saharan Africa is one of the world's fastest-growing regions, and contains nine of the 20 predicted fastest-growing cities to 2020.<sup>1</sup> But rapid economic growth has not translated into job creation<sup>2</sup> or a spreading of opportunities more equitably across society.<sup>3</sup> The need to meet the economic demands of rapidly urbanizing communities and growing youth populations has placed job creation at the top of the policy agenda, and governments are seeking fresh thinking on how to generate inclusive economic growth.

National economies in sub-Saharan Africa are typically characterized by a large number of small businesses that provide the bulk of employment opportunities. These do not have the capacity to generate the number of jobs needed to provide livelihoods for the growing numbers of young people entering the workforce. But there is great potential for small businesses to upscale and grow, to create meaningful employment in more productive, higher-value-adding roles, and to benefit from economies of scale that will enable their products to compete on international markets. Unlocking the potential of small and medium-sized enterprises (SMEs) and achieving greater economies of scale is an essential long-term driver of growth.

Supporting the growth of SMEs in sub-Saharan Africa, as well as the sustainability of larger businesses, will require structural change and policies directly targeted at enabling businesses to grow, including through easing access to finance and improving transport infrastructure. In addition, because of the small size of most internal markets, economies of scale can often only be achieved through regional integration. This can facilitate the flow of goods and services as well as labour and technology, while also supporting the scaling up of local companies.

Companies must grow in order to provide more jobs. Larger companies are more productive, more competitive and make better employers.<sup>4</sup> Macroeconomic data do not tell the whole story: a rising GDP figure is misleading if growth is achieved by exporting a single resource or if the benefits are felt only by a few. A more critical measure is a rise in the quality of life, as measured for instance by the UN Development Programme's Human Development Index. UN Sustainable Development Goal 8 aims to promote sustained, inclusive and sustainable economic growth, full and productive

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<sup>1</sup> City Mayors Statistics (2017), 'The world's fastest growing cities and urban areas from 2006 to 2020', [http://www.citymayors.com/statistics/urban\\_growth1.html](http://www.citymayors.com/statistics/urban_growth1.html) (accessed 20 Aug. 2017).

<sup>2</sup> McKinsey reported in 2012 that only 28 per cent of Africa's labour force had wage-paying jobs, while 63 per cent were in 'vulnerable' employment. It predicted that Africa would create 54 million new jobs by 2022, but would see 122 million people come onto the job market in the same period. Fine, D. et al (2012), *Africa At Work: Job creation and inclusive growth*, McKinsey Global Institute, <http://www.mckinsey.com/global-themes/middle-east-and-africa/africa-at-work> (accessed 20 Aug. 2017).

<sup>3</sup> A World Bank paper found that seven of the 10 most-unequal states in the world are in Africa. Beegle, K. et al (2016), *Poverty in a Rising Africa*, Washington, DC: World Bank, <https://openknowledge.worldbank.org/handle/10986/22575>. Though the impact of opportunity – based on parentage, ethnicity, region of birth, etc. – on equality is the subject of debate, one background paper for the World Bank study, based on large-scale surveys of 13 countries, found inequality of opportunity to be 'very high' in every country under study, though based on much more complex interactions of factors than in Western countries. Brunori, P., Palmisano, F. and Peragine, V. (2015), *Inequality of Opportunity in Sub-Saharan Africa*, Bari: University of Bari, <http://documents.worldbank.org/curated/en/522541470317691539/Inequality-of-opportunity-in-Sub-Saharan-Africa> (accessed 20 Aug. 2017).

<sup>4</sup> A study of company size in Ethiopia concluded that increasing the number of employees from five to 50 increased productivity per unit of labour 10-fold. Söderbom, M. (2012), 'Firm Size and Structural Change: a case study of Ethiopia', *Journal of African Economies*, 21, DOI: <https://doi.org/10.1093/jae/ejr046> (accessed 20 Aug. 2017).

employment and decent work for all.<sup>5</sup> The linkage between poverty and unemployment is clear, just as it is broadly accepted among economists that a young and increasingly urban population represents the potential to increase the labour supply and boost the economy.<sup>6</sup>

This paper provides a snapshot of the current business environment in Nigeria, Tanzania, Uganda and Zambia, as seen by the owners and managers of over 60 local businesses, and an analysis of the constraints and opportunities for company growth in those four countries.<sup>7</sup> While there are some common factors, these countries vary widely in cultural, political, geographic and economic terms. The picture that emerges is therefore equally diverse.

## Africa's economic outlook and the need for job creation

The population of sub-Saharan Africa, currently over 1 billion, is projected to exceed 2 billion by 2050.<sup>8</sup> In order to reap the benefits of its 'youth bulge', the labour pool needs to have access to jobs. If the jobs do not materialize, the results will be highly destabilizing.<sup>9</sup> The continent's economic performance, expressed in terms of growth in GDP per head, is less than half that of South Asia, while Africa has over twice the level of unemployment.

In order to create jobs, Africa needs investment. But while it has 15 per cent of the world's population, it only receives around 4.4 per cent of total foreign direct investment (FDI), about \$54 billion.<sup>10</sup> Expatriate Africans also sent home remittances totalling \$33 billion in 2016,<sup>11</sup> down from \$35.2 billion in 2015.<sup>12</sup> But these inflows are eclipsed by capital flight, especially from resource-rich economies. Ordinary Africans invest in Africa, whereas rather too frequently the very richest do not.<sup>13</sup>

Growth alone is not enough: economic diversity and higher rates of formal employment are critical to developing better governance. Businesses, especially good ones, will not flourish under poor governance.<sup>14</sup> Building well-governed states is tied to business, via the key linkage of tax,

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<sup>5</sup> SDG 8 has a focus on economic growth, increased productivity, diversification, support to entrepreneurship, SME growth and job creation, and the decoupling of economic growth from environmental degradation, with the aim of full employment by 2030. See [sustainabledevelopment.un.org/sdg8](https://sustainabledevelopment.un.org/sdg8).

<sup>6</sup> As one World Bank economist puts it: 'population growth and urbanization go together, and economic development is closely correlated with urbanization'. Fengler, W. (2010), 'Can rapid population growth be good for economic development?', Washington, DC: World Bank, <http://blogs.worldbank.org/africacan/can-rapid-population-growth-be-good-for-economic-development> (accessed 20 Aug. 2017).

<sup>7</sup> The research team interviewed owners and managers of SMEs to identify what they saw as the challenges to growth, as well as senior representatives and founders of large companies to explore what had driven their success. The team also interviewed figures from business organizations and federations, banks and investors, and other experts and academics working on these issues.

<sup>8</sup> United Nations, Department of Economic and Social Affairs, Population Division (2015), *World Population Prospects: The 2015 Revision, Key Findings and Advance Tables*, New York, NY: United Nations, [https://esa.un.org/unpd/wpp/publications/files/key\\_findings\\_wpp\\_2015.pdf](https://esa.un.org/unpd/wpp/publications/files/key_findings_wpp_2015.pdf) (accessed 15 Feb. 2017).

<sup>9</sup> Azeng, T. F. and Yogo, T. U. (2013), *Youth Unemployment and Political Instability in Selected Developing Countries*, Abidjan: African Development Bank, [https://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/Working\\_Paper\\_171\\_-\\_Youth\\_Unemployment\\_and\\_Political\\_Instability\\_in\\_Selected\\_Developing\\_Countries.pdf](https://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/Working_Paper_171_-_Youth_Unemployment_and_Political_Instability_in_Selected_Developing_Countries.pdf) (accessed 15 Feb. 2017).

<sup>10</sup> Services accounted for 48 per cent of the total FDI stock in Africa in 2012, more than twice the share of manufacturing (21 per cent). FDI stock in the primary sector was 31 per cent of the total. United Nations Conference on Trade and Development (2015), *World Investment Report 2015*, Geneva: United Nations, p. x, [http://unctad.org/en/PublicationsLibrary/wir2015\\_en.pdf](http://unctad.org/en/PublicationsLibrary/wir2015_en.pdf) (accessed 15 Feb. 2017).

<sup>11</sup> World Bank (2017), *Remittances to Developing Countries Decline for Second Consecutive Year*, Washington, DC: World Bank, <http://www.worldbank.org/en/news/press-release/2017/04/21/remittances-to-developing-countries-decline-for-second-consecutive-year> (accessed 9 Aug. 2017).

<sup>12</sup> World Bank (2016), 'Remittances to Developing Countries Edge Up Slightly in 2015', Washington, DC: World Bank, <http://www.worldbank.org/en/news/press-release/2016/04/13/remittances-to-developing-countries-edge-up-slightly-in-2015> (accessed 9 Aug. 2017).

<sup>13</sup> Ajayi, S. I. and Ndikumana, L. (2015), *Capital Flight from Africa: Causes, Effects, and Policy Issues*, Oxford: Oxford University Press.

<sup>14</sup> Certain companies will invest in conflict countries to gain attractive resource deals. See Witte, C. T., Burger, M. J., Ianchovichina, E. I. and Pennings, E. (2015), 'Dodging the bullets: An industry-level analysis of multinationals in conflict countries', working paper; and Burger, M., Ianchovichina, E. and Rijkers, B. (2015), 'Risky Business: Political Instability and Sectoral Greenfield Foreign Direct Investment in the Arab World', *World Bank Economic Review* 2015, 30(2).

which is central to the social contract between people and their government, and a driver of accountability. But in much of Africa, governments raise only low volumes of tax. In Nigeria, Tanzania, Uganda and Zambia alike, the tax base is small. Looking at tax revenue as a percentage of GDP, the comparison across three groups of countries in sub-Saharan Africa and other continents is stark (see Table 1). Many African governments are at a disadvantage because they have a small tax revenue base. Furthermore, in many cases tax revenues are dominated by resource rents that are impacted by volatility in international commodity prices.

**Table 1: Tax revenues as % of GDP, 2012**

	Tax revenue (excluding grants and social contributions)	Non-resource component of indirect tax
Nigeria	14.35	2.05
Tanzania	11.49	6.69
Uganda	10.68	6.23
Zambia	16.99	6.84
Chile	20.76	9.96
Georgia	27.86	14.62
Iran	14.21	2.05
Denmark	53.25	n.a.
France	33.56	12.50
Germany	28.92	10.61
UK	30.26	11.31

Source: International Centre for Tax and Development, <http://www.ictd.ac/datasets/the-ictd-government-revenue-dataset>.

The link between corruption and harm to business prospects is not always simple. Entrepreneurs tend to thrive in Nigeria despite high levels of corruption. It is the world's sixth-largest oil producer, and Lagos is a significant finance hub. Uganda, by contrast, may have lower levels of transactional corruption but its formal economy, as a smaller operating environment, is more vulnerable to being captured and constrained by political interests. The difference may simply be a factor of scale: Nigeria's political economy is simply too big and too complex for any single network to dominate, so there is always scope for entrepreneurs. Tanzania is different again, with lingering party control and tension over domestic disparities.

## Scale of investments

There are generally improving economic indicators across the continent. Sub-Saharan Africa is on track to attract more investment than development assistance; and aggregate revenue from taxes increased from \$100 billion in 2000 to \$461 billion in 2014.<sup>15</sup> But performances are of course uneven from country to country. Some attract high levels of investment, while fragile states and those without resource endowments are overlooked. Investment in oil and gas, for instance, can heavily inflate a country's GDP figures, while having only a marginal – or even a negative – impact on its development indicators.

<sup>15</sup> African Development Bank, Organisation for Economic Co-operation and Development and United Nations Development Programme (2014), *African Economic Outlook 2014: Global Value Chains and Africa's Industrialisation*, Paris: Organisation for Economic Co-operation and Development, [http://www.oecd-ilibrary.org/development/african-economic-outlook-2014\\_aeo-2014-en](http://www.oecd-ilibrary.org/development/african-economic-outlook-2014_aeo-2014-en) (accessed 20 Aug. 2017).

**Table 2: Comparative economic size, ease of doing business, and domestic credit to the private sector**

	GDP (\$ million)* (2015)	GDP per head (\$) * (2015)	'Ease of Doing Business ranking' (2016)†	Domestic credit to the private sector (% of GDP) (2015)
Nigeria	1,012	5,438	169	15.65
Tanzania	139	2,583	132	15.17
Uganda	71	1,713	115	13.72
Zambia	60	3,636	98	12.97
Sub-Saharan Africa	3,554	3,439	n/a	46.00‡

Source: World Bank (accessed 22 August 2017).

\* GDP, PPP (constant 2011 international dollars) and GDP per head (constant 2011 international dollars).

† Of 190 countries assessed for the World Bank's *Doing Business 2017* report.

‡ Includes South Africa, where in 2015 domestic credit to the private sector was equivalent to 149.2 per cent of GDP.

A major focus for external investors in Africa is public infrastructure. Roads, railways, bridges, water supply, and power generation and transmission require large investments that can transform entire economies. Such projects are critical, and are necessary preconditions to business growth and the creation of formal employment. Sub-Saharan Africa clearly needs many more of them. But, while they address some of the most pressing structural barriers to growth, they do not directly drive private-sector development, and they are not in themselves sufficient to build diversified economies capable of creating the permanent jobs essential to drive the economy and to broaden the tax base.<sup>16</sup>

There is a 'missing middle' in business financing in Africa. While there are a wide variety of funding vehicles for micro-enterprise, and several major financial institutions that will support larger investments, there is a gap in the availability of accessible finance at a scale appropriate for building up SMEs. This is important, because it is growing existing companies – rather than developing start-ups – that drives productivity growth.<sup>17</sup>

Another significant constraint to company growth is management. There is a skills deficit at the level of both implementation and managerial oversight. Moreover, it is notable that many of the successfully growing companies surveyed in the course of this research are headed by people with high-quality MBAs, all of whom noted the constraints posed by the lack of skilled middle-managers.

## Governance and politics

Overall economic data cannot fully capture each country's specific political complexities. Nor can formal 'doing business' indicators reflect the on-the-ground realities of establishing and growing a successful company. From the perspective of Africa's entrepreneurs, obstacles often include difficulties in registering a business and the cost of engaging with complex bureaucracies, as well as the hidden pitfalls for many informal firms of entering the formal realm of written accounts, tax assessments and employment legislation. Finding the right staff is another challenge, as the need often to draw technical and managerial expertise from regional or international labour pools, in the absence of sufficient local capacity, sits at odds with national imperatives to hire locally.

<sup>16</sup> As opposed to an economy dominated by primary extractive industries.

<sup>17</sup> International Finance Corporation (2013), *Assessing Private Sector Contributions To Job Creation and Poverty Reduction*, Washington, DC: International Finance Corporation, [https://www.ifc.org/wps/wcm/connect/0fe6e2804e2c0a8f8d3bad7a9dd66321/IFC\\_FULL+JOB+STUDY+REPORT\\_JAN2013\\_FINAL.pdf?MOD=AJPERES](https://www.ifc.org/wps/wcm/connect/0fe6e2804e2c0a8f8d3bad7a9dd66321/IFC_FULL+JOB+STUDY+REPORT_JAN2013_FINAL.pdf?MOD=AJPERES) (accessed 20 Aug. 2017).

Moreover, poorly regulated local inputs and supply chains, expensive and uncertain access to electricity, and logistical bottlenecks that can keep goods in transit for weeks, can all make securing export contracts or business development loans extremely challenging.<sup>18</sup>

Many of the challenges to business growth that are discussed here are not unique to sub-Saharan Africa: lack of access to affordable finance, for instance, is a familiar complaint of business people everywhere. All the same, the systems of political governance within which many African banks sit are region- or country-specific. In each of the four countries examined in this paper, businesses tend to minimize or avoid contact with the state for fear of graft, delay or expense,<sup>19</sup> or they find markets already dominated by operators with access to private capital and/or political connections. This risks a self-perpetuating cycle: few challengers emerge to old monopolies; few new jobs are created; and the only entrepreneurs able to succeed are those who are already wealthy. This impedes Africa's vast entrepreneurial enthusiasm and potential, and keeps the majority trapped in insecure, informal employment. In this environment, tax revenues – from businesses and individuals – remain insufficient for government spending to keep pace with the needs of a rapidly expanding population. Inequality is perhaps as much of a threat to Africa's stability as unemployment.

The governments of Nigeria, Uganda, Tanzania and Zambia have all acknowledged the imperative to create jobs. They have also recognized, in different ways, the importance of changing underlying patterns of governance, and, in theory at least, of cracking down on corruption and patronage. Since 2015 new presidents have taken office in Nigeria, Tanzania and Zambia, all of whom made clearing the way for business development and job creation part of their election platform. Uganda's president, in office for far longer, is also now pushing for youth employment through private-sector growth.<sup>20</sup>

The private sector will be the main driver of growth and job creation in sub-Saharan Africa in the 21st century. The interdependence of job creation, socioeconomic development and poverty reduction means that policymakers will need to better understand the drivers of, and obstacles to, job creation if they are to achieve national development goals.

The importance of the private sector for economic growth and social development is notably captured by the Nigerian entrepreneur Tony Elumelu, and what he terms 'Africapitalism'. This concept is a 'call to action' for businesses to make decisions that will increase economic and social wealth, and promote development in the countries and communities in which they operate. According to its proponents, 'Africapitalism' will ultimately help businesses become more profitable, as members of the communities they serve become more prosperous consumers, healthier and better-educated employees, and even entrepreneurs who go on to become suppliers and service providers themselves.<sup>21</sup>

This research paper draws on the insights provided by over 60 interviews in Nigeria, Tanzania, Uganda and Zambia to help better understand what businesses, policymakers, financiers and international partners are currently doing, and can do in future, to create a business environment conducive to job-creating enterprise growth.

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<sup>18</sup> These factors were cited several times across interviews in the four countries.

<sup>19</sup> There were a variety of reasons given for this across the four countries: in Nigeria government was associated with old-fashioned business practices and monopolies, in Uganda and Zambia concerns centred on corruption and cost, and in Tanzania concerns were state bureaucracy and restrictive regulation.

<sup>20</sup> The Ugandan government has recently announced a new \$250 million National Action Plan on Youth Employment, though it is not yet implemented or funded.

<sup>21</sup> This paragraph is adapted from a personal perspective submitted to Chatham House by Tony O. Elumelu, CON. For further information on 'Africapitalism', see Elumelu, T. (2013), *Africapitalism: The Path To Economic Prosperity and Social Wealth. Rebuilding and Re-branding Africa as a Land of Investment, Innovation and Entrepreneurship*, Lagos: The Tony Elumelu Foundation, <http://www.issuelab.org/resources/15291/15291.pdf> (accessed 30 Aug. 2017).

## 2. Nigeria

Nigeria's population is fast approaching 200 million,<sup>22</sup> more than double the size of any other African country, and around one-fifth of sub-Saharan Africa's population. The country's capacity to meet the needs of its growing population has been undermined by a marked slowdown in the economy over the last five years, chiefly associated with declining oil revenues. Nigeria recorded negative GDP growth in 2016. Since mid-2014 the export price of Nigerian crude oil has fallen by over 60 per cent, down to \$45 a barrel in November 2016 and remaining close to this price in early 2017. Prior to the decline in oil prices, oil accounted for around 70 per cent of government revenues. The government is currently so short of cash that many civil servants are on a basic wage, and in some states government workers have simply not been paid.<sup>23</sup>

Nigeria's capacity to meet the needs of its growing population has been undermined by a marked slowdown in the economy over the last five years, chiefly associated with declining oil revenues.

Half of Nigerians are between the ages of 15 and 34. Unemployment particularly affects women, young people, those who have received little education, and rural populations. Living in a city means greater access to schools (especially for women), lower fertility rates and higher chances of employment, which has helped drive rapid and ongoing urbanization – currently at some 50 per cent.

A 2002 World Bank study showed that companies had a highly skewed distribution by size: 60 per cent of all manufacturing firms employed between 20 and 49 employees, yet accounted for only 12 per cent of employment. In contrast, companies with more than 500 employees accounted for the bulk of sectoral employment, and 53 per cent of employment in manufacturing.<sup>24</sup> A decade-and-a-half later, the dominance of a few large firms continues – particularly concentrated in Lagos and the southern regions generally.

Rapid cuts in government spending have resulted in depressed wages for civil servants (variously reported to number between 800,000 and 1 million workers), especially beyond the major urban and administrative centres. This has led to lower levels of consumer spending, potentially impacting business income, growth prospects and investor confidence. Oil production has been hit by continued attacks on infrastructure, while companies also suffer from constraints on foreign exchange, low levels of lending to the private sector and poor infrastructure, all of which keep production costs high. The situation is compounded by ongoing security concerns in the northeast region and in the Niger Delta.

A senior analyst at Lagos Business School, in an interview for this paper, suggested that the economic downturn can be regarded as a positive driver of change for business, in that it has significantly

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<sup>22</sup> UN data project that the population (190,886,000 in 2017) will reach 200,962,000 in 2019 and 206,153,000 in 2020. Source: United Nations, Department of Economic and Social Affairs, Population Division (2017), *World Population Prospects: The 2017 Revision* (accessed 20 Jul. 2017).

<sup>23</sup> Akwagyiram, A. and Onuah, F. (2016), 'Two-thirds of Nigerian states struggling to pay salaries: president Buhari'. Reuters, 28 April 2016, <http://www.reuters.com/article/us-nigeria-government-debt-idUSKCN0XP200> (accessed 8 Aug. 2017).

<sup>24</sup> Söderbom, M. and Teal, F. (2002), *The Performance of Nigerian Manufacturing Firms: Report on the Nigerian Manufacturing Enterprise Survey 2001*, Oxford: Centre for the Study of African Economies, University of Oxford; and Marchat, J. M. et al (2002), *Results of the Nigeria Firm Survey: Regional Program on Enterprise Development*, Washington, DC: World Bank.

refocused Nigeria's entrepreneurs away from the oil and gas sector, and towards a more diverse and sustainable set of businesses based on the domestic market rather than a narrow export stream.<sup>25</sup> The downturn may also have had an impact on business culture: given the absence of a ready pipeline of oil-revenue-backed credit, businesses have had to apply discipline, challenging any expectation of fast money for little effort.<sup>26</sup>

## Big country, big disparities

National-level analysis does not tell the whole story. Disparities at the state level are stark: the northern states are more rural; their citizens tend to have lower education levels and higher fertility rates; and there is currently widespread food insecurity. Famine has left an estimated 4.7 million people in the northeast of the country in need of emergency food assistance.<sup>27</sup> The southern states are generally more urban, have better-educated populations, lower fertility rates, and import food from the northern states. Conflict-affected states – Borno, Delta and Rivers – have high levels of debt.

The long-term dominance of hydrocarbons in Nigeria's economy has been reflected in weak development in revenues from the non-oil sector. So, while the oil-service industries in Port Harcourt provide Rivers State with some internal revenue, the northeast region (Borno, Jigawa, Gombe, Adamawa and Yobe states) has a very small tax base. The northern region's Kano State, with an estimated 10 million people, has a tiny internal income. The sole exception is Lagos, where internally generated revenues are significantly larger than the federal contribution, and which received 77 per cent of Nigeria's bank credit in 2015.<sup>28</sup>

## The policy reaction

When President Muhammadu Buhari took office in 2015, Nigeria's economy was in rapid decline and economic diversification was imperative. In 2016, his government agreed to fully implement the Nigeria Industrial Revolution Plan – first announced under the Jonathan administration – and established a Presidential Enabling Business Environment Council. The ministry of industry, trade and investment has been promoting the Nigerian Export–Import Bank as a vehicle for driving non-oil sectors as sources of foreign exchange, and there are numerous business-support initiatives in the major urban centres, including training courses for business skills and small-scale start-up funds. Business figures say that the Buhari government is fully supportive.

But significant obstacles to business development remain. Strict constraints have been imposed on spending in foreign currencies, making it difficult for SMEs to buy and import materials or equipment. Many key sectors – energy in particular – are considered to be over-regulated, and the view persists that the government remains reluctant to ease its direct control over service provision.

Moreover, there is a suspicion that this reluctance reflects the vested interests of big-business elites with political connections that dominate the market under the prevailing conditions. While not

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<sup>25</sup> Interview, Lagos, November 2016.

<sup>26</sup> Ajayi and Ndikumana (2015), *Capital Flight from Africa*.

<sup>27</sup> World Food Programme (2017), 'Nigeria', country page, <http://www1.wfp.org/countries/nigeria> (accessed 19 June 2017).

<sup>28</sup> Moghalu, K. (2016), 'How to achieve inclusive growth in Nigeria', 22 June, Reston, VA: the Whitaker Group, <http://thewhitakergroup.us/how-to-achieve-inclusive-growth-in-nigeria/> (accessed 15 Feb. 2017).

necessarily an example of outright corruption, imports of staple foods are one area in which a handful of dominant companies accrue significant profits from policies that deter investment in domestic agribusiness.

In terms of steering policy towards supporting the expansion of SMEs, a large and vocal number of trade associations are capable of lobbying at the state and federal levels. Areas of complementary and mutual benefit, for instance between growers and millers, represent an opportunity for future coordination between business actors.

## The view from the SMEs

The size of Nigeria's population means that businesses are highly conscious of working in a volume market. Margins can be small, but volume will still generate profits. Scaling up would seem to be an obvious and advantageous move for businesses, yet very few firms have succeeded in doing so. In part, this is because the highly unequal distribution of wealth encourages companies to establish themselves through the provision of goods and services to the emerging – but still relatively small – middle class, and only then making the significant investment needed to make the major transition to scale and mass-market entry.

Many of the SME figures interviewed as part of the research for this paper were highly ambitious – representing businesses ranging from small start-ups with aspirations to significantly change local energy production with photovoltaic systems, to relatively sizeable companies developing large-scale fabrication capacity for the offshore oil and gas industry. These interviewees are not looking at existing success stories as models or ideals for their companies alone; rather, they want to develop their sectors. One said:

If we train 60 welders to international standards and then we retain the best five, and the others find work with our competitors, we consider that a benefit to us, and our competitors, and because of our competitors' existence and excellence, we build Nigeria's capacity as a centre for engineering. Even if the welders we train go and work overseas, if our training holds them in good light, they fly our flag. We see training at scale as a win-win.<sup>29</sup>

Such scale of vision is also notable in other sectors. For instance, even though Nigeria does not have an established 'coffee culture', the owner of a small chain of coffee shops expressed the ambition that the chain's success can also, in providing an out-of-office meeting place for business contacts that has not previously existed in Nigeria's major cities, serve as a stepping stone to building a commercial culture.<sup>30</sup> The vision in this case is thus for incremental and also systemic change.

Issues raised by private-sector interviewees can broadly be categorized as: finance, infrastructure, lack of human resources, and the broader policy environment – particularly tax.<sup>31</sup>

Throughout the interviews conducted, the issue of corruption generally arose in the contexts of harmful theft from workplaces – for example, the replacement of generator diesel with water, or the continued personal use of company vehicles; or of the dominance of a few major industrial

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<sup>29</sup> Interview with Jadesimi Jide, Ladol Fabrications, Lagos, November 2016.

<sup>30</sup> Confidential interview, Lagos, November 2016.

<sup>31</sup> This was also the conclusion of a Chatham House study on Nigeria's informal economy. See Koni Hoffman, L. and Melly, P. (2015), *Nigeria's Booming Borders: The Drivers and Consequences of Unrecorded Trade*, Chatham House Report, London: Royal Institute of International Affairs, <https://www.chathamhouse.org/publication/Nigerias-booming-borders-drivers-and-consequences-unrecorded-trade> (accessed 15 Feb. 2016).

players in specific markets – essentially complaints about monopolies.<sup>32</sup> All the same, such dominant businesses were seen as declining in both the private and public sectors, and were viewed as a remnant of the ‘old men’ generation of powerbrokers.

## Finance

There is a clear finance gap. All the interviewees described the lack of access to, as well as the cost of, finance as a critical factor holding back the growth of their businesses. Nigeria has a wide range of finance deals available for very small start-ups, offering loans well below \$1,000. Above this level, the field is smaller and more competitive. Of the 13 companies surveyed, all but three were started using a combination of personal and family savings. One company had secured a bank loan; one had backing from the Africa Enterprise Challenge Fund<sup>33</sup> and a donor, and one had private-equity support. Getting into a bankable and commercially viable state – ‘getting on the step’ – tends to be limited to those companies that can provide collateral or demonstrate considerable equity in other assets.

It is clear that the finance environment in Lagos is tough, in part because competition is intense, and businesses that have a demonstrable and robust level of performance can be ruined by competitors replicating their business at below-cost. For instance, in the area of web-based marketing, there are new companies offering online sales of consumer goods (the many home-grown Nigerian ‘Amazon’ clones) but these already have a patchy reputation – apparently arising from confusion over which companies can physically deliver the goods.

Nigeria’s banks are, moreover, widely seen as too risk-averse, effectively preferring to make small, short-term loans at very high interest rates. In the words of one banker-turned-investor: ‘Nobody wants to invest in the mid-ground because of the risks.’<sup>34</sup> Many business people complain that banks favour short-term loans for trade, and investments in tech and high-value land developments. Otherwise, what finance is available tends to go particularly to people working in banking, to those who have collateral, or to those associated with a wealthy family name. The government’s promotion of agribusiness means that it is possible to access 10-year loans with single-digit interest rates for projects in this area, although again competition for finance is tough.

Notwithstanding such obstacles, the view from Lagos is broadly optimistic. Nigerian business people are often bullish, pointing out the rigour that financial constraints impose – ‘only the best businesses will succeed because only the best businesses are bankable’ – and that overcoming the logistical hurdles makes businesses robust – ‘if we can operate in Nigeria, we can operate anywhere’.<sup>35</sup> The potential is there for a shift in financing patterns should a smaller and more aggressive bank come to challenge the status quo. As the banker-turned-investor put it:

If one bank takes the risk, changes both its policies and its management practices, then they will succeed – because, like so many things in Nigeria, the volume will provide companies that will perform and carry the losses of those that don’t.<sup>36</sup>

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<sup>32</sup> Interviews, Lagos, November 2016.

<sup>33</sup> The Africa Enterprise Challenge Fund (AECF) is a \$256 million private sector challenge fund that provides catalytic funding to enterprises in 24 countries in sub-Saharan Africa. The fund supports innovative commercial businesses in the agribusiness, renewable energy and adaptation to climate change technology sectors with the aim of reducing rural poverty, promoting resilient rural communities and creating jobs through private sector development. See AECF (2017), ‘AECF: About Us’, <https://www.aecfafrica.org/index.php/about-us> (accessed 23 August 2017).

<sup>34</sup> Interview, Lagos, November 2016.

<sup>35</sup> Ibid.

<sup>36</sup> Ibid.

## Infrastructure

Improved infrastructure would bring huge benefits to business operations in Nigeria. The foremost complaint from SME interviewees was over electricity: just having to purchase and operate a diesel generator can double a company's start-up costs.<sup>37</sup> And if, for instance, a food-processing business is reliant on a generator for cold storage, it has to buy two generators to cover for breakdowns. Generators require fuel, servicing and maintenance; and they represent 'dead capital' to companies, which bemoan the fact that the cost of producing their own power can have a negative effect on their competitiveness. SME interviewees also called for increased electricity transmission and distribution into the hinterland where land and labour prices are lower.

The foremost complaint from SME interviewees was over electricity: just having to purchase and operate a diesel generator can double a company's start-up costs.

The road network was the second most prevalent complaint among interviewees. The poor condition of many of Nigeria's main roads means that they see off ordinary trucks in the space of two years. This equates to a loss to businesses of over \$6,000 a year for each vehicle, with the result that basic operating costs are far higher than they should be. For the nationally critical agribusiness ventures that need to move large volumes of food across country, the state of the roads also means slow distribution and high losses of product.

Some SME interviewees considered that the development of a reliable and efficient rail corridor would bring significant benefits. This would, *inter alia*, provide bulk grain transport from the north to the south, and establish the central components of a long-distance cold chain from Lagos to Kano. There have been numerous unfulfilled promises to renovate Nigeria's rail network, although the 2016 opening of a commuter-based railway linking the federal capital, Abuja, to the residential town of Kaduna is an indicator – albeit on a small scale – of possible progress.

## Human resources

There is little doubt that there is a legacy of poor business management, and there is a chronic need for more middle managers.<sup>38</sup> Managers frequently talk about 'making the transition' from a family-owned set-up with informal business practices to a much more formal company structure with prescribed and process-driven behaviour. A related theme common to many interviews was the discordant relationship between employees and employers. These two factors – management quality and labour relations – are closely associated, and must therefore be tackled in parallel.

Although the Nigerian labour market is vast, with a large pool of readily available human capital, finding the right people is very time-consuming in this context. Any public offer of work elicits a huge number of applicants. Many smaller employers looking for qualified staff resort to hiring via social networking sites (such as LinkedIn) and by direct invitation. Employers interviewed during the research for this paper complained that it was hard to find staff, especially unskilled workers,

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<sup>37</sup> Interviews, Lagos, October 2016.

<sup>38</sup> African Management Initiative (2012), *Catalyzing Management Development in Africa, Identifying areas for Impact*, [https://c.ymcdn.com/sites/www.gbsnonline.org/resource/collection/C7F63EF4-0CDC-4A6F-9805-DA0680C0FD88/AMI\\_interim\\_report\\_.pdf](https://c.ymcdn.com/sites/www.gbsnonline.org/resource/collection/C7F63EF4-0CDC-4A6F-9805-DA0680C0FD88/AMI_interim_report_.pdf) (accessed 20 Aug. 2017).

who would trust their employers and work for the company's – as opposed to their own – interests. Most of the employers in urban areas cited problems with irregular timekeeping and petty theft among employees.

Employers described their efforts to change the employer–employee relationship, specifically by empowering and incentivizing staff. Changing attitudes within a workforce is a long-term task, and demands a transition to new structures and management styles. Among all the entrepreneurs interviewed, the one topic that created the most positive and animated discussion was the changes that occur in people's lives as a result of regular employment and empowerment: it is possible to imagine a virtuous circle whereby improved business practices materially change workers' lives, encouraging in turn sustained attention to management quality and further innovation.

For instance, one of the factors that enabled change was to incentivize the shift from cash payment to bank transfer of wages. While many workers may have a poor level of literacy and may not hold a bank account, they probably do own a mobile phone. Offering a small pay rise to an employee if they open a bank account that allows mobile access builds the employee's trust in banks and can greatly assist in promoting personal and household saving. A single mother can, for example, work and save money to pay for her children's education; and because her wages are paid directly into her own account, her money is more likely to remain hers to control. This transition in transparency, trust and empowerment is critical both to forming a more efficient and self-guiding workforce, and to encouraging employers to move to more formal, structured corporate behaviour – which may in turn enable access to finance and further stimulate growth.

#### Box 1: Case studies – LADOL and WestAfricaENRG

**LADOL**, a services company for the oil and gas industry, is making efforts to address the skills shortage by creating its own Upskilling Academy, offering skills training in areas ranging from practical disciplines through to management, leadership, communications, and personal health and hygiene. The first of an intended set of schools within the academy, SANTA (the School for Advancing Nigerian Technology Acquisition), will train 250 apprentices annually, with a focus on skills including welding, basic firefighting, drilling and subsea disciplines. Training typically takes place within year-long intensive courses. The scheme is closely supported by the Nigerian Content Development and Monitoring Board as part of its local-capacity development initiative.

**WestAfricaENRG**, a waste management and recycling company, has found that it has been very difficult to recruit skilled and semi-skilled workers and to shape recruits into a team that works for the company as opposed to working for themselves. Management of unskilled workers has thus focused on continuous training, as well as on changing the workplace culture through safety messages at the start of every working day and imposing strict penalties for non-compliance with health and safety protocols. Some 35–40 per cent of the initial staff intake have stayed with the company.

## Tax

Most of the entrepreneurs interviewed during the research for this paper cited the complexity and opacity of the tax regime as a challenge to the development of their businesses. Although accounts varied, it was clear that there are four federal company taxes, at least two sets of taxes at state level, and several local-government-area taxes. Some of these taxes appear to run counter to the interests of business growth. For instance, a company can be taxed on the name board or company signage outside its premises, and there is a tax on corporate logos displayed on company-owned vehicles.

Most importantly, business figures complain about the significant overlap between federal and state taxes, as well as about multiple taxes on the same sets of profits.

If company taxes were simpler, clearer and less onerous, then fewer companies might be tempted to avoid tax payments, the cost of collection could be reduced, and the same amount of tax – or more – could be collected.

The issue of tax goes further than restrictions on the growth of individual businesses, given that Nigeria has a low ratio of tax receipts to GDP.<sup>39</sup> Notably, if company taxes were simpler, clearer and less onerous, then fewer companies might be tempted to avoid tax payments, the cost of collection could be reduced, and the same amount of tax – or more – could be collected. Clear, pro-business tax reform could result in enhanced government revenues that could then be invested in social welfare, education or infrastructure. Many SME interviewees pointed out that the growth in mobile banking also provides an opportunity to develop a better-integrated tax system.

## Agribusiness

The SME managers interviewed spoke perhaps most passionately about agriculture and the prospects for agribusiness than about any other area of business. There was an acute awareness that building Nigeria's ability to feed itself – beyond Lagos and other 'rich' areas of the country – was of the highest priority. It is, moreover, interesting to note the professional background of agro-entrepreneurs: those interviewed included lawyers, economists and engineers.

While such owners and managers are not farmers and have no technical farm-management training, they clearly understand finance, markets and the imperative to develop Nigeria's self-sufficiency. The range of farm models is broad – from extensive maize production with highly stratified and organized out-grower models, to highly focused and intensive production – the aim is consistent: to develop a profitable model for social change based on commercializing agriculture whereby farming is both profitable for farmers and fulfils the ambition to guarantee Nigeria's food security.

The companies surveyed in the sector were primarily founded with private capital, although one aquaculture entrepreneur is now looking to grow his business using mobile-based crowdfunding: individual investors are able to use the technology to 'buy' catfish on the owner's farm, allowing the farm to invest the credit in fish stocks and feed (see First Clarias case study in Box 2). When the fish reach market, a dividend is paid back into the investor's mobile account as credit.

Many of Nigeria's agribusinesses (particularly its rice and maize farmers) must, however, compete with imports of grains and other staples. The political connections of the main importers are such that they can drive the market price down to a point at which Nigerian producers risk making a loss. Market intelligence is therefore critical for the farmers, as is a growing and increasingly influential producers' lobby.

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<sup>39</sup> Despite the oil and gas industry's dominance of government revenues, Nigeria retrieves only 7 per cent of its GDP in tax – compared with an average of 20 per cent in its peer group of emerging economies, and value-added-tax in Nigeria is 5 per cent compared to 17–18 per cent in Mozambique and Rwanda. International Monetary Fund (2016), *Nigeria: Selected Issues*, Washington, D.C: International Monetary Fund, <https://www.imf.org/external/pubs/ft/scr/2016/cr16102.pdf> (accessed 15 Feb. 2017); and Rumney, E. (2016), 'Nigerian tax system in need of reform, say experts', Public Finance International, 18 July 2016, <http://www.publicfinanceinternational.org/news/2016/07/nigerian-tax-system-need-reform-say-experts> (accessed 15 Feb. 2017).

### Box 2: Case studies – AACE Foods and First Clarias

**AACE Foods** is a producer, refiner and buyer of foods and spices, engaging with some 10,000 farmers. It is the lead actor in a system running between farmers, transport companies and bulk retailers that focuses on adding value and making direct returns to farmers from products marketed both within Nigeria and externally. The company is primarily a food processor and marketer – not a landowner or grower – but it is closely involved in building quality and consistency in the feedstock. The key to maintenance of quality is traceability: every bag of produce delivered to AACE Foods is traceable back to the individual farmer through a discrete reference number, which helps the company to target and address issues of substandard produce directly.

**First Clarias** is a medium-scale fish-farming company, producing catfish for the local market. It has developed a mobile-based crowdfunding app as a solution to overcome bottlenecks and other obstacles such as demands for collateral in ‘conventional’ and other financing models, having initially sought backing from agricultural and commercial banks as well as microfinance institutions. The reality remains, however, that agribusiness is not risk-free, and requires a commitment in terms of developing a formal management structure, community liaison and guaranteeing security of people’s investment.

### Box 3: Case studies – Technology and business growth

The three Nigerian companies cited here demonstrate the potential impact of technology on business growth.

**Cafe Neo** is a chain of coffee shops in Lagos with ambitions to expand its business, selling premium African coffee in its own shops and other retail outlets, first across Nigeria and then across the continent. Lack of access to foreign exchange is a major constraint to companies wishing to import goods, and Neo recently circumvented this obstacle by buying coffee from Rwanda using bitcoin, a process that helped to keep transaction costs down.

**Babban Gona**, a major maize producer, offers support to farmers that includes everything needed to grow a crop of maize, including seed, fertilizer, bags to put the harvested maize in, and even needles and thread to close the bag. Before the growing season, each grower’s field is recorded on a GPS device and an assessment of soil conditions is made. The package that is then delivered to the farmer is individually tailored to their situation. During the growing season, the crop is monitored via photographs of fields sent to Babban Gona for analysis. This system will shortly be supplemented by high-resolution satellite imagery, which will allow Babban Gona to target individual fields for fertilizer inputs or to counter crop diseases at the earliest stage.

**Arnergy** is providing solar-energy systems on the basis of a business model that overcomes the high initial costs through a credit facility that is repaid over three years. Payments are facilitated by the company’s proprietary power controller, which includes telemetry that allows both the client and Arnergy to monitor the power production of the individual unit. The customer then makes payments to the company online.

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## 3. Tanzania

Tanzania exemplifies the urgent need to create new jobs in order to meet the needs of a burgeoning population. Dar es Salaam, the commercial capital, is one of the 10 fastest growing cities in the world, and looks set to become a megacity (i.e. one with a population of over 10 million) by the early 2030s.<sup>40</sup> The country's population is projected to more than double by 2050, and over 800,000 Tanzanians are joining the job market every year.<sup>41</sup> Creating youth opportunities is therefore a key challenge for the government and the private sector. Scaling up established businesses, as well as attracting new business to the country, is crucial for its future prosperity and stability.

Over the last decade, Tanzania has seen solid growth (averaging some 6.5 per cent annually), and the World Bank has projected 7.1 per cent GDP growth for 2017/18. However, this expansion has mostly been driven by non-labour-intensive sectors – such as mining and quarrying, communications, and banking and finance – and has thus not translated into significant job creation.<sup>42</sup>

Although youth unemployment is relatively low on the mainland (at around 5 per cent according to data published in 2013),<sup>43</sup> most young people are employed in precarious jobs in the agricultural sector. Young people living in urban areas are more likely to be unemployed than are those living in rural areas, and young women are half as likely as young men to be in regular employment. The situation is markedly worse in Zanzibar: youth unemployment is over 30 per cent, and young people make up the majority of those who are underemployed or economically inactive.<sup>44</sup>

The first comprehensive survey of Tanzania's MSMEs, published in 2012, found that there were more than 3 million small businesses in Tanzania but only a tiny number of medium-sized ones. Of the small businesses surveyed, 68 per cent were found to be single-employee, while less than 3 per cent had five or more employees. Only 44.7 per cent of small-business owners stated that they kept financial records.<sup>45</sup>

Basic services – including education, healthcare, sanitation, access to water and electricity, and transport infrastructure – remain in much need of improvement across the country. Hopes that the numerous offshore gas deposits discovered between 2010 and 2015 would be a means of rapidly strengthening the provision of these services have proved premature. The global slump in oil and gas prices, as well as China's economic slowdown, have complicated Tanzania's route to becoming a major gas exporter.

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<sup>40</sup> Lupala, J. and Kiunsi, R. (2011), 'Dar es Salaam city, 50 years to come: conceptual considerations', unpublished workshop Working Paper presented during the 50 Years Anniversary of the University of Dar es Salaam, Tanzania.

<sup>41</sup> World Bank (2014), *Tanzania – Productive jobs wanted*. Washington, DC: World Bank, <http://documents.worldbank.org/curated/en/554601468312598716/pdf/904340v20ESWOPFinal0September02014.pdf> (accessed 30 Mar. 2017).

<sup>42</sup> World Bank (2016), *Tanzania economic update: the road less traveled – unleashing public private partnerships in Tanzania*, Washington, DC: World Bank Group, <http://documents.worldbank.org/curated/en/302151467992051044/Tanzania-economic-update-the-road-less-traveled-unleashing-public-private-partnerships-in-Tanzania> (accessed 31 Mar. 2017).

<sup>43</sup> Food and Agriculture Organization of the United Nations (2013), *Quick overview of the Decent Rural Employment situation in Tanzania Mainland and Zanzibar*, [http://www.fao.org/fileadmin/user\\_upload/fao\\_ilo/pdf/Other\\_docs/Quick\\_Fact\\_Sheet\\_TZ\\_FINAL.pdf](http://www.fao.org/fileadmin/user_upload/fao_ilo/pdf/Other_docs/Quick_Fact_Sheet_TZ_FINAL.pdf) (accessed 6 Apr. 2017).

<sup>44</sup> World Bank (2015), *Project Information Document: Appraisal Stage (TZ-Zanzibar Improving Student Prospects Project)*, Washington, DC: World Bank, <http://documents.worldbank.org/curated/en/614411468336088639/pdf/PID-Appraisal-Print-P153277-04-27-2016-1461772071811.pdf> (accessed 3 Apr. 2017).

<sup>45</sup> Financial Sector Deepening Trust and Ministry of Trade and Industry (2012), *National Baseline Survey Report for Micro, Small, and Medium Enterprises in Tanzania*, [http://www.fsdt.or.tz/wp-content/uploads/2015/12/MSME\\_National\\_Baseline\\_Survey\\_Report\\_2012.pdf](http://www.fsdt.or.tz/wp-content/uploads/2015/12/MSME_National_Baseline_Survey_Report_2012.pdf) (accessed 3 Apr. 2017).

Nonetheless, the country has advantages that could boost its growth and industrialization, including a wealth of untapped agricultural land (with 5 per cent currently cultivated, but 20 per cent considered cultivable)<sup>46</sup> and regional demand for many of its crops, several ports (including three deep-water ones), and an increasing labour-cost advantage in comparison to East and Southeast Asia.

## The domestic political landscape

Since taking office as president in 2015, John Magufuli has devoted considerable energy to following through on his campaign slogan ‘Hapa Kazi Tu’ (‘work and nothing else’), notably personally dismissing public officials and others he has judged to be lazy or corrupt. During a recent tour of an uncompleted water project in Lindi, he was reportedly so incensed by the lengthy delays suffered that he reportedly confiscated the passport of the Indian contractor in charge of the project.<sup>47</sup> Magufuli has, furthermore, tasked his government with achieving strong growth while simultaneously cutting expenditure.

One interviewee cited the Fair Competition Commission (FCC) as one state institution in need of reform, noting that its wide remit is inhibiting business and investment. The ability to acquire a Tanzanian firm is an important component of attracting FDI and of enabling foreign firms to enter and compete in the domestic market (given that an established Tanzanian firm will already have employees, offices, clients, etc.). Until mid-2017 the FCC had to be notified of mergers of assets and acquisitions if the combined assets of the entities involved exceeded TZS 800 million (around \$350,000). This was a low enough threshold that it affected a large number of potential deals, including small-scale, apparently uncontroversial cases. The Fair Competition (Threshold for Notification of a Merger) (Amendment) Order, 2017, which came into effect in June, raised the merger notification threshold to TZS 3.5 billion.<sup>48</sup> This should ease the FCC’s caseload and improve the investment climate. However, penalties for non-compliance remain severe: not only do parties risk a fine of 5–10 per cent of their annual turnover, but directors and managers are also personally liable and can be fined 5–10 per cent of their annual income.<sup>49</sup> Both these factors constrain FDI and foreign firms wishing to enter the market. When companies do notify the FCC of plans for mergers or acquisitions, receiving a verdict can prove difficult. The managing director of one multinational highlighted that the FCC’s work stalled for nine months after three commissioners retired in 2015. Hearings to clear the backlog of cases only resumed in 2016 with the appointment of new commissioners.<sup>50</sup>

## Regional and global relations

In several interviews, business people highlighted the country’s strategic location and its proximity to large and strong regional economies as important factors in their ability to scale up their activities. Tanzania is a member of the East African Community (EAC), together with Burundi, Kenya, Rwanda, South Sudan and Uganda, but in the past it has not been among the most active participants.

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<sup>46</sup> PwC (2013), *Africa gearing up: Tanzania*, <http://www.pwc.com/gx/en/industries/transportation-logistics/publications/africa-infrastructure-investment/africa-infrastructure-report.html> (accessed 4 Apr. 2017).

<sup>47</sup> Ng’wanakilala, F. (2017), ‘Tanzania’s Magufuli orders seizure of expatriate construction workers’ passports’, Reuters, 3 March 2017, <http://www.reuters.com/article/us-tanzania-politics/tanzanias-magufuli-orders-seizure-of-expatriate-construction-workers-passports-idUSKBN16A10L> (accessed 1 Sept. 2017).

<sup>48</sup> Tanzania: Fair Competition (Threshold for Notification of a Merger) (Amendment) Order, 2017, [http://www.competition.or.tz/PUBLISHED\\_DOCUMENTS/Orders/ORDER\\_threshold\\_20170706.pdf](http://www.competition.or.tz/PUBLISHED_DOCUMENTS/Orders/ORDER_threshold_20170706.pdf) (accessed 22 Aug. 2017).

<sup>49</sup> Clyde and Co (2010), ‘Merger control in Tanzania’, <http://www.clydeco.com/insight/article/merger-control-in-tanzania> (accessed 31 Mar. 2017).

<sup>50</sup> Mbashiru, K. (2016), ‘Tanzania: 23 Company Complaints Set for Hearing By FCC’, *Tanzania Daily News*, 24 June 2016, <http://allafrica.com/stories/201606240030.html> (accessed 1 Sept 2017).

Notably, it was not part of the so-called ‘coalition of the willing’ forged by Kenya, Uganda and Rwanda in 2013 to drive forward integration in areas such as trade and infrastructure development. While these three countries all implemented an EAC deal facilitating the free movement of people between Kenya, Uganda and Rwanda, Tanzania did not follow suit, maintaining a \$3,000 fee for citizens of other EAC countries to set up a business. However, in November 2016 President Magufuli gave in to pressure from Kenya’s President Uhuru Kenyatta and halved the fee to \$1,500.

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A positive development in the country’s integration into the global economy was the introduction, in 2016, of the Tanzania Customs Integrated System, an online system for downloading and processing customs documents, which has reduced the time required for exporting and importing goods. One interviewee with a business that operates across East African countries reported that exports of goods from Tanzania to Kenya are now proceeding without problems. However, imports from Kenya to Tanzania remain difficult or impossible.

## Access to finance

A common complaint among those interviewed regarding the situation for businesses in Tanzania was the difficulty – or indeed the impossibility – of accessing finance to enable SMEs to grow. A senior employee of an agri-processing firm reported that all attempts to take out loans had been thwarted by high interest rates; the business had received large orders from the Gulf states and from East Asia, but had no option but to decline these because it was unable to expand to fulfil the orders. A senior director of a logistics firm also reported having encountered the obstacle of high interest rates, and said that stringent loan conditions had also blocked the company’s attempts to secure credit. Research published in 2013 showed that loans to SMEs in Tanzania carry interest rates of 18 to 22 per cent (as well as other fees); that only 10 per cent of firms with fewer than 100 employees had access to formal credit; and that lending to SMEs accounted for just 14 per cent of bank lending.<sup>51</sup>

However, there have recently been some encouraging changes. In the World Bank’s 2017 *Doing Business* report, an area of dramatic improvement for Tanzania was in the ‘Getting Credit’ indicator. The country moved up 108 positions year on year, having expanded borrower coverage and improved access to credit information via credit bureaus.

Female entrepreneurs find it particularly difficult to access finance. The proportion of SMEs owned by women grew from 35 per cent in the 1990s to 54 per cent in 2012. More than 99 per cent are microenterprises with fewer than five employees, and business activity tends to be concentrated in informal, low-growth and low-profit areas including food vending, tailoring and charcoal selling. Very few sell their products beyond the local market. Customary norms whereby it is rare for women to own land and assets are a crucial barrier to growth for female-owned SMEs, as they are unable to offer these as collateral for loans.<sup>52</sup> To address this problem, the Tanzania Women’s

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<sup>51</sup> Roe, A. and Stone, R. (2013), *SMEs and their financing in Tanzania*, Oxford Policy Management.

<sup>52</sup> Mori, N. (2014), *Women’s entrepreneurship development in Tanzania: insights and recommendations*, Geneva: International Labour Organization, [http://www.ilo.org/wcmsp5/groups/public/---ed\\_emp/---emp\\_ent/---ifp\\_seed/documents/publication/wcms\\_360426.pdf](http://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---ifp_seed/documents/publication/wcms_360426.pdf) (accessed 5 Apr. 2017).

Bank (in collaboration with real estate company Ardhi Plan) started lending registered plots of land to female entrepreneurs in 2015. Within a year, more than 1,000 women in Dar es Salaam had managed to secure loans to expand their business through this scheme. In November 2016, furthermore, the African Development Bank and the largest commercial bank in Tanzania, CRDB Bank, signed a \$120 million loan agreement, part of which is earmarked for advancing lending to SMEs, particularly those owned by women. CRDB Bank aims to use its geographical reach to extend loans to SMEs in rural and urban areas.

Customary norms whereby it is rare for women to own land and assets are a crucial barrier to growth for female-owned SMEs, as they are unable to offer these as collateral for loans.

There is scope for greater innovation in the SME-financing sector. The financing company Equity for Tanzania (EFTA), which offers equipment loans to SMEs and farmers, is an example of how a leasing model can operate effectively for Africa's 'missing middle'. Securing an equipment loan (up to a maximum value of \$60,000) from EFTA requires no collateral: businesses use EFTA-purchased equipment while paying off the loan over three years and then take full ownership of the equipment at the end of the period. If the borrower is unable to pay, EFTA repossesses the machinery – something that happens in just 5–6 per cent of cases. Since its establishment by Equity for Africa in 2003, EFTA has made 75 investments worth \$465,000; it aims to reach a portfolio of \$50 million by 2020.<sup>53</sup>

## Access to finance in the agricultural sector

In August 2016 the Tanzania National Microfinance Bank set aside more than TZS 500 billion (about \$223 million) to provide credit for agricultural development over the next five years. Better long-term financing is crucial to helping this key sector (which contributes over 30 per cent of GDP<sup>54</sup>) shift away from smallholder production, industrialize, expand and access new markets. The most recent census of agriculture showed that small-scale farms occupy 91 per cent of total farmland and have experienced a much lower growth rate than other sectors.<sup>55</sup>

### Box 4: Case study – Africado

An example of an agricultural company that has succeeded by employing new technology and enabling farmers to access international markets is Africado, which produces and exports avocados. It was set up in northern Tanzania in 2007 and, as a result of public- and private-sector investment, was working with more than 2,000 farmers in nine districts as at 2015, with plans eventually to provide employment for a further 300 local workers.<sup>56</sup> By introducing modern irrigation systems, training material for smallholders covering areas such as cultivation, quality assurance and food safety, and advanced processing and packaging technologies, Africado is achieving strong sales across a number of EU countries, including the UK, the Netherlands and Spain.

<sup>53</sup> Equity for Tanzania (undated), 'Our History', [http://www.efta.co.tz/?page\\_id=162](http://www.efta.co.tz/?page_id=162) (accessed 4 Apr. 2017).

<sup>54</sup> Food and Agriculture Organization of the United Nations (2016), 'AQUASTAT country profile: United Republic of Tanzania', Rome: Food and Agriculture Organization, [http://www.fao.org/nr/water/aquastat/countries\\_regions/TZA/](http://www.fao.org/nr/water/aquastat/countries_regions/TZA/) (accessed 3 Apr. 2017).

<sup>55</sup> World Bank (2017), *United Republic of Tanzania Systematic Country Diagnostic: To the Next Level of Development*, Washington, DC: World Bank, <http://documents.worldbank.org/curated/en/510681488823616126/pdf/TZ-SCD-Final-Approved-by-AFRVP-03012017.pdf> (accessed 5 Apr. 2017).

<sup>56</sup> GlobalG.A.P. (2015), 'Africado', Cologne, [http://www.globalgap.org/uk\\_en/Profiles/b41f41b1-42c0-11e6-8751-6805ca037347/](http://www.globalgap.org/uk_en/Profiles/b41f41b1-42c0-11e6-8751-6805ca037347/) (accessed 5 Apr. 2017).

### Box 5: Case study – Natureripe Kilimanjaro Ltd

**Natureripe** was established as a family-owned mango farm in 2006, and has since grown into a producer of jams, spreads, peanuts and cashews, employing 25 people. It sells its products to supermarkets and other clients such as Air Tanzania. Despite significant challenges – including vulnerabilities to adverse weather and natural pests, international competition from companies that benefit from state subsidies or offer higher standards of packaging, rising costs of raw materials, delays in payments, and interest rates that make capital too risky to access – Natureripe is looking to expand into other regions of Tanzania. Its success hitherto is partly down to a focus on products that do not require complicated machinery.

## The Enterprise Growth Market

The Dar es Salaam Stock Exchange's Enterprise Growth Market (EGM) segment was established in 2013 with the aim of enabling SMEs in areas such as agribusiness, tourism and manufacturing to list and to raise capital in securities in order to finance their further growth. By early 2017 there were five companies listed on the EGM (Yetu Microfinance Bank, Maendeleo Bank, Mkombozi Bank, Swala Energy and Mufindi Community Bank). Several factors may be preventing or deterring SMEs from considering listing, including not being able to meet – or to demonstrate meeting – listing criteria (variously including composition of the board of directors, audits and financial statements, and minimum number of shareholders) and concerns about the EGM's low liquidity and consequently low likely capital gains. A 2017 report by FSD Africa, the Nairobi-based financial-sector development programme, which has been closely involved in setting up the EGM, concluded that more should be done in the following areas to invigorate this segment of the stock exchange: offering technical support to smaller businesses to help them list; conducting outreach campaigns to raise public awareness of the EGM, especially outside Dar es Salaam; and attracting more institutional investors, such as pension funds.<sup>57</sup> One positive development on the latter front could be recent reforms allowing pension funds to invest up to 40 per cent of their funds into equities. So far, however, the EGM does not appear to be a viable route for most Tanzanian SMEs to access finance.

## Concerns about taxation

Tanzania's complex tax regime was highlighted by interviewees as a key area in need of improvement. According to the World Bank's 2017 *Doing Business* report, both the complexity and the cost of making tax payments had increased in the year under review (i.e. in 2015/16). Businesses surveyed for this paper expressed concern regarding the impact of President Magufuli's push to increase tax revenue: interviewees highlighted that a single business could be subject to a very large number of different taxes (up to 49 per year, a much higher number than the sub-Saharan average of 38),<sup>58</sup> and spoke of feeling targeted – rather than supported or encouraged to grow – by the government. Assessing and reforming the many small taxes levied on businesses that do not generate much revenue for the state and which frustrate SMEs would be a positive step for the government to take.

<sup>57</sup> Financial Sector Deepening Trust and FSD Africa (2017), *Catalysing Investment Finance for SMEs: FSD Tanzania's Foray into the Enterprise Growth Market*, <http://www.fsdafrica.org/wp-content/uploads/2017/03/FSDT-Case-study.pdf> (accessed 5 Apr. 2017).

<sup>58</sup> World Bank (2015), Tanzania economic update: why should Tanzanians pay taxes? The unavoidable need to finance economic development, Washington, DC: World Bank, <http://documents.worldbank.org/curated/en/374861468116334584/pdf/97720-ESW-Tanzania-Economic-Update-Report-PUBLIC-as-of-7-2-15-6PM.pdf> (accessed 5 Apr. 2017).

## Education and skills

Interviewees agreed that the lack of education and professional skills among the workforce seriously constrains their ability to grow their businesses and increase productivity. Education levels among business owners themselves are also low: only 20 per cent of small business owners in Tanzania have more than some secondary education; while 70 per cent have completed primary school or less.<sup>59</sup> One CEO considered that his company's advantage over competitors stems from his own strong educational background: he completed an MBA and a postgraduate degree, while most other business owners in his sector did not finish secondary school.

Interviewees agreed that the lack of education and professional skills among the workforce seriously constrains their ability to grow their businesses and increase productivity.

The managing director of a successful conglomerate lamented that it has become extremely difficult to hire foreign workers to fill specialist roles for which it is hard to recruit among the domestic workforce, such as qualified and experienced accountants. He highlighted that banks and telecoms companies – restricted in their hiring of foreign labour – are poaching skilled Tanzanian nationals from other industries and thus fuelling shortages elsewhere. The Non-Citizens (Employment Regulations) Act, adopted in 2015, introduced tougher rules for subsidiaries of multinationals wishing to hire foreign workers, and was described by one interviewee as undermining Magufuli's attempt to attract more FDI.

The lack of employment opportunities for locals in Zanzibar's booming tourism industry has been particularly contentious. Businesses there struggle to recruit qualified candidates from the islands, and instead import labour from the mainland and abroad. There are some promising examples of initiatives to address this situation, such as the TUI Care Foundation and the NGO Kawa Training Centre's partnership to open up job opportunities in the tourism sector for young Zanzibaris. They partnered in 2015 to offer training programmes for tour guides, and by the end of 2016 80 per cent of those who had completed one such programme had found permanent employment.<sup>60</sup>

The Vocational Educational and Training Authority (VETA), established in 1994, now has a wide reach, with over 100 training centres across the country. Its broad remit includes setting standards and financing other training providers. However, its courses are often seen as a last resort, and VETA graduates still struggle to find work – with the post-technical training employment rate reported to be around 14 per cent.<sup>61</sup> A 2014 World Bank report urged greater private-sector involvement to ensure courses are tailored to the needs of the labour market.<sup>62</sup> There have been some promising developments on this front, such as the Tanzania Youth Scholars programme, which has offered more than 1,500 disadvantaged young people access to vocational training at VETA aligned

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<sup>59</sup> Dinh, Hinh T. et al (2012), *Light manufacturing in Africa*, Washington, DC: World Bank, <http://siteresources.worldbank.org/DEC/Resources/LightManufacturingInAfrica-FullReport.pdf> (accessed 4 Apr. 2017).

<sup>60</sup> TUI Care Foundation (2016), *We Care: The Magazine of the TUI Care Foundation*, <https://www.smarticle.com/app/#/html5/f4365de8e9/jfaceh0j3BPSq/page/1> (accessed 4 Apr. 2017).

<sup>61</sup> Haji, M. (2015), *Youth employment in Tanzania: Taking stock of the evidence and knowledge gaps*, Ottawa: International Development Research Centre, [https://www.idrc.ca/sites/default/files/sp/Documents%20EN/Youth\\_Employment\\_TANZANIA\\_REPORT\\_web-FINAL.pdf](https://www.idrc.ca/sites/default/files/sp/Documents%20EN/Youth_Employment_TANZANIA_REPORT_web-FINAL.pdf) (accessed 4 Apr. 2017).

<sup>62</sup> World Bank (2014), *Tanzania – Productive jobs wanted*. Washington, DC: World Bank Group. <http://documents.worldbank.org/curated/en/554601468312598716/pdf/904340v20ESW0P0Final0September02014.pdf> (accessed 30 Mar. 2017).

with the needs of the local firms, as well as securing them internships with companies including Serena Hotel, Serengeti Breweries and Dangote Cement.<sup>63</sup>

The first Enhancing Employability through Vocational Training (EEVT) project, implemented from 2012 to 2015 by VETA together with the international development organization VSO and BG Tanzania, was deemed so successful that in 2016 the Tanzania Liquefied Natural Gas Plant Project consortium (BG/Shell Group, ExxonMobil, Ophir Energy, Pavilion Energy and Statoil) donated \$1.9 million to a second phase. EEVT focuses on strengthening vocational training to meet the demand for skilled labour in the extractive industries in the southern regions of Mtwara and Lindi. Following EEVT Phase I, more than half of VETA graduates were reported to have found a job within six months of completing their training.<sup>64</sup>

Business leaders highlighted several recent and long-term problems with Tanzania's education system, including the previous government's decision in 2015 to make Kiswahili the sole language of instruction in schools, with teaching in English to be phased out.

Business leaders highlighted several recent and long-term problems with Tanzania's education system, including the previous government's decision in 2015 to make Kiswahili the sole language of instruction in schools, with teaching in English to be phased out. Since independence in 1961, public education has been bilingual, but has not sufficiently equipped enough students with the English-language skills that are attractive for employment in businesses seeking growth. Concerns were raised when the change was announced that Tanzania would be weakening the ability of its future workforce to communicate with counterparts both regionally and in the global economy. It should be noted, however, that the bilingual system in Tanzania has long disadvantaged students from poorer and rural backgrounds, as they have often struggled to make the jump from studying English as a foreign language in primary school to following English-medium instruction across subjects in secondary school. Advocates of the switch to Kiswahili instruction believe that it will improve the attendance and results of students from rural and poorer backgrounds, thereby narrowing currently wide disparities in education outcomes.

## Technology and digital skills

A common theme raised in a number of interviews was the great contribution technology can make to growing a business. One CEO described that ensuring their company has a strong online and social media presence was critical to its success. While the firm's competitors tend to have a limited profile – or no profile – on the internet, numerous international clients have found the company online and now comprise the bulk of its business.

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<sup>63</sup> International Youth Foundation and US Agency for International Development (2016), *Tanzania Youth Scholars: Lessons learned and best practices from working with vulnerable youth*, [http://www.iyfnet.org/sites/default/files/library/TYS\\_CaseStudy.pdf](http://www.iyfnet.org/sites/default/files/library/TYS_CaseStudy.pdf) (accessed 4 Apr. 2017).

<sup>64</sup> VSO (2016), *Tackling youth unemployment through vocational skills in Tanzania*, <https://www.vsointernational.org/fighting-poverty/improving-livelihoods/tackling-youth-unemployment-through-vocational-skills-in> (accessed 4 Apr. 2017).

A senior director of another company expressed concern that Tanzania is lagging behind Kenya and Uganda when it comes to technology. Kenya is aiming to equip 1 million young people with digital skills in the next year, and Uganda has established four tech start-up incubators in Kampala, whereas Tanzania has no comparable ambition at present. In Kenya, 73 per cent of manufacturing and service firms with at least five employees use the internet, while in Tanzania the rate is 22 per cent.<sup>65</sup>

Equipping young people in Tanzania with digital marketing and online-sales skills could therefore improve their chances of employment or their ability to set up a successful business, as well as benefiting existing businesses by connecting them with new clients or consumers (foreign and domestic), and increasing their productivity.

#### Box 6: Case study – Kays Logistics

**Kays Logistics**, a transport company based in Dar es Salaam, has found technology to be crucial to its business. Some 70 per cent of its business is with international companies, which is at the core of its success – partly because of fewer delays in payment from these firms compared with Tanzanian clients. This has been possible because of investment in technology, and using the internet to promote and advertise the company, including through social media. It assesses that 98 per cent of customers have found the company via the internet, and some of the biggest projects have been sourced through LinkedIn. In the company's view, Tanzanian companies do not use the internet enough.

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<sup>65</sup> World Bank (2016), *World Development Report 2016: Digital Dividends*, Washington, DC: World Bank, <http://documents.worldbank.org/curated/en/896971468194972881/pdf/102725-PUB-Replacement-PUBLIC.pdf> (accessed 5 Apr. 2017).

## 4. Uganda

Uganda has now passed three decades under Yoweri Museveni, who was returned for a fifth elected term as president in 2016. It was once seen as one of Africa's outstanding success stories, with stability and good governance returning to a country long plagued by violence. Infrastructure was rebuilt, growth rates were high, and investors returned. The poverty rate has been reduced, from 62.2 per cent in 2003 to 34.6 per cent in 2013.<sup>66</sup>

But over the past few years its star has showed signs of waning. GDP growth was 4.6 per cent in 2016, compared with a peak of 10.8 per cent achieved in 2006.<sup>67</sup> Weak exports, in part due to a collapse in demand from South Sudan, low levels of private-sector lending, and reduced agricultural output in 2015 as a result of adverse climatic conditions have left the government managing an economy that, while broadly stable, does not appear to be set for dynamic take-off.

Such a take-off is acutely necessary, however, if Uganda is to meet the needs arising from its gathering demographic wave. The median age of the population is just 15; it has the largest percentage of population under 30 in the world, and the population is projected to exceed than 100 million by 2050.<sup>68</sup> One NGO estimated the youth unemployment rate to be 62 per cent in 2012.<sup>69</sup> Many of the jobs that are available are informal, insecure and unproductive.

**The median age of the population is just 15; it has the largest percentage of population under 30 in the world, and the population is projected to exceed more than 100 million by 2050.**

Uganda's potential is vast in terms of resources – notably fertile soils, a generally settled climate, and a rapidly growing population – and given the extent of the regional markets that it is well placed to access. Basic infrastructure has also improved markedly, including roads and electrification. This continues, notably in the form of the Karuma and Isimba hydropower projects and the Kampala–Entebbe express highway.

The problem is that most start-ups close again very rapidly. Of those that survive, few reach any scale. As a result, the jobs that are created are low-quality and short-term, and generate little tax revenue for the government, or savings and pensions capital for the banks. Significant infrastructural issues remain. The cost of power has come down,<sup>70</sup> but uptake is reported to remain low, in part because tariffs remain at a rate that few can afford.<sup>71</sup> Storage is another key problem, particularly

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<sup>66</sup> IMF (2017), *Uganda: Seventh review under the policy support instrument – Press Release; And Staff Report*, IMF Country Report No. 17/7, January 2017, [www.imf.org/~media/Files/Publications/CR/2017/cr1707.ashx](http://www.imf.org/~media/Files/Publications/CR/2017/cr1707.ashx) (accessed 21 Aug. 2017).

<sup>67</sup> World Bank (2017), World Bank Data: Uganda, <http://data.worldbank.org/country/uganda?view=chart> (accessed 21 Aug. 2017).

<sup>68</sup> Republic of Uganda (2011), *The State of Uganda Population Report 2011*, Kampala: Population Secretariat, Ministry of Finance, Planning, and Economic Development, Republic of Uganda, <http://esaro.unfpa.org/en/publications/state-uganda-population-report-2011> (accessed 21 Aug. 2017).

<sup>69</sup> Action Aid International Uganda, Development Research and Training, and Uganda National NGO Forum (2012), *Lost Opportunity? Gaps in Youth Policy and Programming in Uganda*, [http://www.actionaid.org/sites/files/actionaid/youthreport-final\\_0.pdf](http://www.actionaid.org/sites/files/actionaid/youthreport-final_0.pdf) (accessed 15 Feb. 2017).

<sup>70</sup> World Bank (2016), 'Uganda Poverty Assessment 2016: Fact Sheet', <http://www.worldbank.org/en/country/uganda/brief/uganda-poverty-assessment-2016-fact-sheet> (accessed 15 Feb. 2017). The cost-to-production ratio has dropped from 35 per cent to 9 per cent, and more communities have also been connected to the electricity grid, but from a very low base, particularly in the regions: the proportion of households with access to electricity stands at 3.7 per cent, 5.8 per cent and 8.6 per cent in the northern, eastern and western regions respectively.

<sup>71</sup> Interviews, Kampala, October 2016.

for food processing: despite the high number of agri-processing SMEs, these often only hold a few weeks of product due to a lack of storage.<sup>72</sup> One long-established agribusiness was using commercial buses to move its product from the smallholder producers to a central warehouse.

In any case, infrastructure development is by no means a universal remedy. There has been little ‘natural’ growth of successful business able to expand to fill the spaces created by Uganda’s improved infrastructure. In fact, although new businesses continue to be created at a high rate, and the overall climate for business is assessed as relatively positive, the private sector is nonetheless affected by what the IMF has called ‘an air of uneasiness and uncertainty’.<sup>73</sup> According to one interviewee in late 2016, no company had listed on the stock exchange for the last three years.<sup>74</sup> The ‘missing middle’ is a Ugandan reality.

Interviewees cited three broad barriers to the scaling-up of businesses: financing; the lack of a business culture and a weak skills base; and the challenge posed by the informal sector.

## The costs of finance

The most commonly cited barrier was that finance is highly expensive and largely out of reach. Commercial banks charge very high rates of interest – some 25 per cent, although this can rise to as high as 48 per cent.<sup>75</sup> Although the international financial institutions report a satisfactory level of capitalization among banks,<sup>76</sup> many interviewees argued that a low level of capitalization, caused by low savings rate and a lack of pension funds, was material to low levels of lending. The Ugandan government, faced with budget shortfalls due in part to low tax takes, itself borrows much of the available capital. While there have been some efforts at modernizing the banking sector, the situation seems unlikely to change in the short to medium term, in part because traditional banks are reported not to want cheap money coming into the market, and so have resisted reform.<sup>77</sup>

More fundamentally, the rates charged by banks reflect the fact that giving loans to many businesses is very risky. The majority of businesses start as informal, family-run, small enterprises, often dependent on a single individual. They often have limited business knowledge – for example as regards human resources, market research or book-keeping – and may maintain partial, inconsistent or non-existent records. For the banks, therefore, checking the credentials of an applicant or the viability of a loan can be very difficult, time-consuming and expensive, and the high interest rates thus offset these factors and mitigate their exposure. Furthermore, many providers of venture capital are looking to make much larger investments than are appropriate to most SMEs with ambitions to scale up their operations. Bigger firms can access international capital markets, but even then there are drawbacks – notably that borrowing in US dollars leaves them vulnerable to fluctuations in the exchange rate.

These problems are particularly acute in the agricultural sector. It is reported that just 20 per cent of land in Uganda is formally registered, making it in most cases impossible to offer proof of title

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<sup>72</sup> Interview, Kampala, October 2016.

<sup>73</sup> International Monetary Fund (2017), *Uganda: Seventh Review Under the Policy Support Instrument – Press release; and staff report*, Washington, D.C: International Monetary Fund, <http://www.imf.org/external/pubs/ft/scr/2017/cr1707.pdf> (accessed 15 Feb. 2017).

<sup>74</sup> Interview, Kampala, October 2016.

<sup>75</sup> Interviews, Kampala, October 2016.

<sup>76</sup> IMF (2017), *Uganda: 2017 Article IV consultation and eighth review under the policy support instrument – Press release; staff report; and statement by the executive director for Uganda*, IMF Country Report No. 17/206, <http://www.imf.org/en/Publications/CR/Issues/2017/07/12/Uganda-2017-Article-IV-Consultation-and-Eighth-Review-Under-the-Policy-Support-Instrument-45069> (accessed 21 Aug. 2017).

<sup>77</sup> *Ibid.*

as collateral for loans.<sup>78</sup> Those looking to invest in larger-scale mechanized farms cannot buy land with the degree of confidence necessary to invest in production.

Reliance on natural inputs means that smallholders harvest and sell seasonally, so products arrive at the market at the same time, driving down prices. Some interviewees argued that so-called ‘apex’ firms – those that are long established and politically connected – operate as a cartel, dictating prices paid to smallholders and driving up the retail margin. Small producers can therefore neither accumulate capital nor secure loans. While there is some finance available specifically for agriculture – in the form of loans from the Bank of Uganda – this facility is not widely known and is reported often to favour politically connected applicants. Commercial banks do not often lend for agriculture, and there is no agricultural bank.<sup>79</sup>

Without investment in widespread irrigation and mechanization, or increasing the use of fertilizers, agriculture is highly vulnerable to changes in climate and weather conditions. There is, for instance, no Ugandan production of fertilizers, which all need to be imported, and so are too expensive for most farmers. There is no national soil-analysis service, meaning that smallholders cannot reliably choose the correct fertilizer even if they could afford it.

It was widely acknowledged by interviewees that once businesses of all types do reach a take-off point, there are many actors eager to invest – ranging from grant-making bodies to venture capital and state investment funds. But such a path demands a documented track record, and robust structures from companies, meaning that businesses need to ‘get fit for finance’; There are, however, few business development services available to help small businesses prepare themselves for growth: while the cost of obtaining finance is undoubtedly a serious issue, the critical problem may be a lack of ‘investible’ firms.

#### Box 7: Case study – Delight Ltd

**Delight Ltd** is a juice manufacturer which has grown out of a business started in 1996 by a single individual with just \$100 in capital, trading across the Uganda–Kenya border. It now employs 450 people and works with 2,000 out-growers. Delight has its own farm of 1,000 acres, including 800 acres of mango, and has plans to build a processing plant. It expanded into South Sudan, and ran a substantial operation in Juba including a shop and bakery, built using a loan taken out in 2008, at 28 per cent interest. The company was getting 60 per cent of its income from South Sudan before the outbreak of conflict there, and it was obliged to sell its buildings to repay the loan.

Delight is currently working on a project to use mango-growing as a resettlement strategy for people displaced by past conflict in northern Uganda. Delight set up a nursery to propagate seedlings, then got a contract from the government agricultural extension service to supply these to northern Uganda. It is working with 2,300 farmers, clustered into saving groups, saving an average of USh 1,000 per person per week. Once the orchards mature, in 2018, Delight plans to build a processing plant for fresh juice. But finding finance for the plant is proving difficult, and the business needs to bridge the ‘quality gap’ to meet international standards. For Delight, this includes work on handling, transport, storage, processing, packaging and distribution.

<sup>78</sup> World Bank (2015), *Searching for the “Grail”: Can Uganda’s Land Support its prosperity drive*, World Bank Group Report No. 99060, September 2015, <http://documents.worldbank.org/curated/en/58507146800009216/pdf/99060-WP-P155327-Box393200B-OUO-8-V2-UEU6-Fact-sheet-final.pdf> (accessed 21 Aug. 2017).

<sup>79</sup> Ibid. Tanzania, for instance, has the Tanzania Agricultural Development Bank ([www.tadb.co.tz](http://www.tadb.co.tz)) and Ghana the Agricultural Development Bank ([www.agricbank.com](http://www.agricbank.com)). The Uganda Development Bank announced a rebranding and a shift of focus to agriculture in 2015, and claimed at the time that 50 per cent of its portfolio went to agriculture. UGO News (2015), ‘Uganda Development Bank Rebrands With New Corporate Identity’, 26 February 2015.

## Creating a business culture

Many of those interviewed attributed the shortage of ‘investible’ firms to the weakness of business culture and education – they made the case that Uganda lacks an entrepreneurial culture, particularly as compared with neighbouring Kenya. As already noted, most businesses begin as family enterprises, dominated by a single individual, and cannot – or will not – change their practices. Often, small firms do not differentiate between profit and working capital, and so prioritize short-term spending – on education, housing or even luxury goods – over reinvesting in a business. Many attributed this to social pressures to ‘chase status’, which creates an instinct towards short-term consumption over long-term investment, as well as pressure to look after extended families. The prevailing business culture tends to act as a hard cap on the growth of a business, and there is often a steep decline in management competence on the retirement or death of the head of a small enterprise.

Many of those interviewed attributed the shortage of ‘investible’ firms to the weakness of business culture and education – they made the case that Uganda lacks an entrepreneurial culture, particularly as compared with neighbouring Kenya.

Skills are low, notably for management of staff and finances. There are government efforts to improve this, including agencies such as Enterprise Uganda and the Ugandan Investment Authority, but they are relatively small and underfunded. Many interviewees reported that there was a significant gap in supporting companies to formalize business development.<sup>80</sup> Many also spoke of a culture of handouts from government and donors, which results in the most talented individuals being able to access repeated, cost-free external funding without having to demonstrate longevity. Even companies that have received grants – sometimes multiple times – do not improve as there are few costs attached to failure. The Uganda Young People Fund, for instance, was stated to have had a 92 per cent failed repayment rate.<sup>81</sup> Training programmes were described as ‘ineffective and inadequate’ in the words of one 2013 study<sup>82</sup> – and often poorly publicized and understood. The same survey noted a dozen government schemes to help young entrepreneurs, but found that 89 per cent of young people had received no support from them.

While the education system has improved considerably, and basic indicators such as enrolment levels, attendance and literacy have significantly increased, this has come as a result of a focus on primary and secondary education, with an emphasis on theoretical learning over practical knowledge, notably in terms of the technical skills essential to business. As a result, many foreign-owned businesses employ expatriate workers, especially in management and skilled technical roles.

Agriculture is reportedly still seen as the occupation that people default to when they have failed at everything else. This creates a vicious cycle; there are few role models of successful entrepreneurs, particularly in agriculture, so the most talented young people direct their energy elsewhere. And the erosion of agricultural extension services has meant a loss of knowledge among producers: for instance, even if fertilizers were available, their misuse could risk the health both of farmers and of the soil.

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<sup>80</sup> Interviews, Kampala, October 2016.

<sup>81</sup> Ibid.

<sup>82</sup> Global Entrepreneurship Monitor (2013), *Supporting Africa’s Young Entrepreneurs: an investment in job creation and future prosperity for all* (Uganda).

## The lure of informality

The third factor inhibiting the growth of the private sector is the persistence of a very large informal sector. There are thought to be some 2.5 million SMEs in Uganda, but the percentage of these that are registered was said by interviewees to be unknown.<sup>83</sup> Pervasive informality has a deadening impact on business development and the wider governance environment. Businesses that register, pay their taxes and operate in the formal sector can be prevented from reaching take-off point simply because they cannot compete on price with informal firms that pay no tax, have lower overheads and have less contact with government bureaucracy. Products made by informal firms are of uncertain quality and are not easy to regulate, meaning that inputs for other industries are not reliable and quality is not sufficient for export markets.

Although the World Bank gives Uganda a relatively positive assessment in terms of the ease of doing business – ranking it 115 of 190 countries assessed for its 2017 report<sup>84</sup> – this belies the challenge reported by many of those interviewed. Many reported that official registration means becoming a target for tax authorities looking to impose both licit and illicit levies. Registered companies must also have complete records, a challenge for many small family firms that do not have well-developed record-keeping, in the absence of which they can be liable for fines and perhaps difficult questions about their business practices. Thus, even though ‘going formal’ is necessary to access capital, and therefore to grow, it is also a real risk for businesses. In interviews conducted as part of the research for this paper, one long-established medium-sized agricultural business was said to have received no government help at all, and to avoid contact with the state whenever possible: getting official assistance was said to result in no net gain (i.e. the costs involved were equal to as much as was ultimately received), and the help received was of uncertain quality.<sup>85</sup>

It was also commonly argued that businesses are often launched using capital that has been accumulated through informal or even illegal means – such as through the misuse of political authority for gain, unfair access to grants, or private capital from family members or individuals who do not want this to be publicly exposed. Businesses do not want the authorities to ‘see under the hood’, as one interviewee put it, or the scrutiny that external investment would bring, and so instead choose to remain informal.

## Interlinked challenges

None of these barriers to growth exists in isolation. Informality has many knock-on impacts. One important result of firms remaining unofficial is that formal records are not collected and best practices are not documented. More acutely, even many of those businesses that do grow into formality and scale are reluctant to share the dynamics of their journey. There is thus a very thin analytical base in the country on why businesses succeed or fail, and potential investors remain cautious because they cannot get a clear image of the possible return on their investment.<sup>86</sup>

Thus the government tax take remains low, wages remain low and uncertain, and there are few incentives for businesses to accumulate capital or to make long-term investments. The result is that

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<sup>83</sup> Ibid. A 2013 report cited a figure of 1.8 million informal businesses, which would mean that some 72 per cent of businesses are informal. Global Entrepreneurship Monitor (2013).

<sup>84</sup> Uganda is rated higher than many other sub-Saharan African states, although it ranks less favourably against neighbouring Kenya (at 92).

<sup>85</sup> The business reported receiving diseased saplings as part of a government programme. Interview, Kampala, October 2016.

<sup>86</sup> Ibid.

the government is forced to rely on borrowing, taking up much of the scarce capital that is available. And even then agencies and ministries are underfunded, and government spending on is curtailed.

Government agencies find it challenging to enforce rules around quality, sourcing or practices. The one charged with enforcing standards, for instance, was reported not to have the capacity to carry out its functions.<sup>87</sup> The National Agricultural Advisory Service – critical in an agrarian country such as Uganda – has an annual budget of just \$60 million, estimated by one interviewee to be five times less than necessary.<sup>88</sup> This lack of financing and capacity means that standards are not enforced, and counterfeiting is widespread and poorly policed, which makes competing on quality difficult. One interviewee from an expanding seed production company cited competition from counterfeit seeds as its largest problem, exacerbated by a ‘price-sensitive market’ in which people would rather buy cheaply than guaranteeing quality.<sup>89</sup> Smuggling undermines productive industries like fisheries and forestry, and weak government capacity lowers confidence across the system, again fuelling banks’ reluctance to lend and investors nervous. Obtaining permits to export into more highly regulated markets such as the EU is even more difficult and expensive.

The companies that can succeed in this environment have access to capital – financial and political – through private means, either as wealthy individuals or overseas investors. They are able to navigate the challenges of formality, often through importing management or technical expertise, access to offshore capital or personal connections. They can be extremely successful: as noted at the beginning of the chapter, Uganda has enormous potential, internally and in regional markets, and has made significant progress in making up its infrastructural shortfall.

But the majority of ordinary Ugandan entrepreneurs continue to be excluded. This contributes to maintaining the culture of short-termism, deterring entrepreneurs from reinvesting in businesses that remain informal and precarious. There are few role models, and there has been little analysis possible of pathways to success. And the prevailing business culture further forces banks and other investors to remain cautious about lending, and to impose extremely high rates of interest when they do. It is what one observer called a ‘vicious cycle of private capital and poor governance’.<sup>90</sup>

#### Box 8: Case study – Rosebud

**Rosebud Ltd** is a flower-growing company, part of the Ruparelia Group, that has grown from 13 hectares in 2000 to 80 in 2016, employing 1,500 people, of whom 60 per cent are women, and capturing 40 per cent of Uganda’s flower-export market. It is the first flower farm in East Africa with 100 per cent hydroponic production, and gained certification in 2007 enabling it to export into international markets. Uganda’s reliable climate allows consistent rather than seasonal production, and the company’s location close to Lake Victoria allows access to international air links via Entebbe airport.

However, challenges for Ugandan firms in the horticulture sector include the lack of locally produced inputs, relatively costly electricity and water supplies, and a lack of technical skills in the local job market. Hydroponic flower production is complex, expensive and risky, but Rosebud demonstrates the scale of success possible in Uganda if businesses have the necessary leadership, capital and expertise.<sup>91</sup>

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<sup>87</sup> Ibid.

<sup>88</sup> Ibid.

<sup>89</sup> Ibid.

<sup>90</sup> Ibid.

<sup>91</sup> Rosebud (2017), ‘Rosebud’, <http://www.rosebudlimited.com/> (accessed 21 Aug. 2017).

## Governance

The problems listed above are fundamentally ones of governance. Uganda has made great strides in terms of government effectiveness through the years of President Museveni's tenure. But it has come under increasing criticism latterly for the concentration of power in the hands of the executive, the proliferation of districts, policy incoherence and corruption. According to Transparency International's Corruption Perceptions Index, Uganda was ranked 127th in 2010, 142nd in 2014 and 151st in 2016.<sup>92</sup> The UK Department for International Development and the Irish government suspended development aid in 2012 over allegations of misappropriation of funds.<sup>93</sup>

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The issues facing those trying to help the private sector are not necessarily rooted in poorly designed regulation or restrictive laws – in fact, most interviewees were positive both about the quality of the regulatory environment and the government's sincerity in wanting to stimulate growth. The international financial institutions are broadly happy with government policy. Many interviewees, including from private-sector organizations and industry bodies, reported a positive working relationship with government, including collaborating to change the regulatory framework, which had become substantially more business-friendly in recent years.<sup>94</sup> So the issue is not overt government policy.

Rather, the issue is one of implementation. The government is reported to lack cohesion, with policy directives coming directly from the president's office rather than through normal ministerial channels, translated by a complex and overlapping series of institutions operating underneath. This results in competition between agencies and duplication of effort, and undermines a coordinated strategic policy response. It also enables the partial or weak implementation of regulation – a key factor in maintaining space for illicit businesses practices, particularly by those with the necessary political connections. As noted, regulations are frequently not enforced, making exporting very difficult, and counterfeiting is only weakly policed.

Implementation is also undermined by corruption and patronage, which results in resources earmarked for the support of businesses being diverted to private hands. For instance, theft of inputs – notably fertilizer – reached such a level that responsibility for the delivery of agricultural extension services was taken from the National Agricultural Advisory Service and given to the military. Politically connected individuals protect and profit from smuggling – for instance of illegally caught fish from Lake Victoria or timber from the Democratic Republic of the Congo (DRC) – that undermines formal business.<sup>95</sup>

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<sup>92</sup> Transparency International (2017), 'Corruption Perception Index: Overview', <https://www.transparency.org/research/cpi/overview> (accessed 21 Aug. 2017).

<sup>93</sup> *Guardian* (2012), 'UK suspends aid to Uganda as concern grows over misuse of funds', 16 November 2012, <https://www.theguardian.com/global-development/2012/nov/16/uk-suspends-aid-uganda-misuse> (accessed 21 Aug. 2017).

<sup>94</sup> *Ibid.*

<sup>95</sup> Uganda used to have 21 fish-canning plants on the shores of Lake Victoria, a number that has now been reduced to eight. These operate at 20–25 per cent capacity as stocks have been decimated by illegal fishing, with the resulting catch smuggled across the border into the DRC. Regulations to monitor fishing have not been enforced.

Furthermore, profits from graft can be laundered back through so-called ‘briefcase businesses’ run by associates or family members of highly placed individuals, which take up market share that would otherwise be available to ordinary entrepreneurs. The long-term result is that, over time, the private sector becomes dominated by those with political connections, private capital (however accumulated) or overseas links. The government is under budgetary pressure, and has committed to increasing its tax take by 0.5 per cent of GDP, including through more stringent audit of medium and large firms.<sup>96</sup> This is of course a justifiable aim, but one that could reinforce the pressures that already keep many businesses informal, particularly if such audits are only partially applied. It must go together with measures to help entrepreneurs take the leap into formal business, such as investment in skills training, accessible finance and strategic investment in key inputs. A business world dominated by a politically connected elite and external investors is unlikely to provide the answer to Uganda’s future employment needs.

#### Box 9: Uganda’s timber industry

The nascent timber industry provides a good example of Uganda’s potential and the challenges that remain. The sector has benefited from progressive government decision-making, including allowing access to unused government forestry reserve by commercial cultivators and a government grant scheme for producers. The industry reports a positive relationship with government and with the foreign-owned businesses that have hitherto dominated the sector and which have collaborated with domestic producers on best practices and technology transfer. Uganda is well placed to compete in the region, and is ahead of its potential competitors in specialist products such as telegraph poles.

However, there are significant risks, from climate and natural pests or from smuggling (largely from the DRC), that undercut local production, as well as a high barrier to entry for new producers, both in meeting the initial cost of seedlings and in the necessary technical knowledge to compete. The first cohort of new producers is yet to harvest its first crops, which will result in a large ‘windfall’ profit. This will test the appropriateness of the tax system as well as the discipline of the producers to re-invest profit into a sustainable sector.

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<sup>96</sup> International Monetary Fund (2017), *Uganda, Seventh Review Under the Policy Support Instrument*.

## 5. Zambia

Positive economic fundamentals and relative stability have given Zambia a reputation as one of the top investment destinations on the continent; a point underlined by the market entry of a number of regional and international banks, insurers, retailers and service providers. SME expansion can underpin diversification of the economy and generate employment opportunities, foster innovation and support the equitable distribution of wealth.

From independence in 1964 to 1991, Zambia was under a one-party regime and had a centralized economy. This was followed by a largely peaceful transition to a multiparty democracy with a market economy, which was seen as an example for other African countries. Since then, there has been increasing recognition of the importance of the contribution of the SME sector to employment, growth and sustainable development.<sup>97</sup> However, the economy is still dominated by mining and the former national enterprises.

Zambia is highly dependent on its extractive resources. Mining continues to dominate exports, is the main source of foreign exchange and remains a considerable contributor to government revenues. Copper and ancillary products are forecast to contribute over 70 per cent of total exports earnings beyond 2020.<sup>98</sup>

Dependence on copper means that the economy is extremely vulnerable to price volatility on international markets, with the price of the commodity falling by over 50 per cent between 2011 and 2016.

Dependence on copper means that the economy is extremely vulnerable to price volatility on international markets, with the price of the commodity falling by over 50 per cent between 2011 and 2016.<sup>99</sup> Zambia's growth slowed as a result, a problem compounded by high levels of debt incurred for large infrastructure investments as well as by a drought that impacted agricultural output and electricity generation, creating a power crisis. There were no fiscal buffers in place to manage this scenario as no savings had been made or stabilization measures carried out when the economy was prospering. This left the government with limited fiscal space to compensate for lower growth. The slowdown also exposed the reality that the benefits of resource-driven growth were mainly being felt by the Lusaka elite and that inequality had increased through the boom years.<sup>100</sup>

The correlation between commodity prices and economic growth highlights an urgent need to diversify the economy. The 2015 Living Conditions Monitoring Survey revealed that 54.4 per cent

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<sup>97</sup> Major economic sectors of the economy include mining, agriculture, tourism, manufacturing and services.

<sup>98</sup> International Monetary Fund (2015), *Zambia: 2015 Article IV Consultation – Press Release; Staff Report; and Statement by the Executive Director for Zambia*, Washington, D.C: International Monetary Fund, <https://www.imf.org/external/pubs/cat/longres.aspx?sk=42999.0> (accessed 12 Apr. 2017).

<sup>99</sup> InfoMine (undated), 'Copper price', <http://www.infomine.com/ChartsAndData/ChartBuilder.aspx?z=f&gf=110563.USD.lb&dr=3m&cd=1> (accessed 12 Apr. 2017).

<sup>100</sup> Mills, G. (2017), 'Zambia's Mining Sector Schizophrenia', *Lusaka Times*, 9 March 2017, <https://www.lusakatimes.com/2017/03/09/zambias-mining-investor-schizophrenia/> (accessed 12 Apr. 2017).

of the population is poor, with 40.8 per cent living in extreme poverty.<sup>101</sup> But mineral extraction will not be a mass job-creator. Although the second largest employer in the country is the largest mining company, First Quantum Minerals, the sector accounts for only about 2 per cent of employment. The manufacturing, mining and construction sectors together account for 8.3 per cent of jobs, compared with 49 per cent in agriculture and 12 per cent in trade, wholesale and retail distribution.<sup>102</sup> Furthermore, government and parastatals still account for 46.5 per cent of formal jobs.<sup>103</sup>

The transition privatization of nationalized industries has led former parastatals to have a considerable market share in their sectors, as domestic demand – in a market of 13.5 million people, the majority of whom are in low-income households – has not supported competition.

Of the top 10 companies by revenue in 2015, three are mining companies, two are former state enterprises, one is state-owned, one is an international fuel company and two are international telecoms businesses. The only home-grown private enterprise is Zambeef – the frequently cited Zambian success story that started as a butcher’s shop and grew to be an international, vertically integrated, agri-processing business. These companies have a revenue equivalent to around one-quarter of GDP. This combined with government spending accounts for around half of the economic activity in the country.

Former state enterprises also dominate the non-mineral export market. Zambia Sugar PLC accounts for over 85 per cent of sugar production. Lafarge has a 68 per cent share of the cement market. Both were privatized in the mid-1990s; between them they account for a considerable proportion of non-extractive export earnings.

Despite continuing challenges to its development, Zambia’s private sector was among the best performing in Southern Africa in 2016, with only Mauritius, Botswana and South Africa doing better. A positive forecast for the economy is expected to be underpinned by a strengthening copper price over the long term, improvements in the fiscal deficit, and greater confidence in the economy. Ongoing discussions with the IMF are expected to lead to agreement on a programme of support worth up to \$1.4 billion, which will further boost confidence.<sup>104</sup> New energy generation capacity is intended to improve power supply, and mitigate against the effects of climate change, and rainfall variability, on electricity production.

## A positive policy environment for SMEs

A new government was formed after elections in December 2016. Its declared objectives – to curb domestic spending, address inflation and promote structural economic diversification and support for SMEs – were received with cautious optimism.

The establishment of the Industrial, Commercial and Trade Policy in 1994 was an early case of state encouragement of private enterprise. If the new government is to achieve its broader national development goals outlined in the Fifth National Development Plan and in Zambia’s Vision 2030, it needs to develop a strong SME sector. The economic situation presents opportunities for a more

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<sup>101</sup> Central Statistics Office (2015), *Zambia: 2015 Living Conditions Monitoring Survey Key Findings*, Lusaka: Central Statistics Office, p. 9, <http://www.zamstats.gov.zm/report/Lcms/LCMS%202015%20Summary%20Report.pdf> (accessed 17 Feb. 2017).

<sup>102</sup> Central Statistical Office and Ministry of Labour and Social Security (2015), *2014 Labour Force Survey Report*, Lusaka: Central Statistical Office, [http://www.mlss.gov.zm/upload/Labour\\_Force\\_2014/2014\\_LFS\\_FULL\\_FINAL\\_Report.pdf](http://www.mlss.gov.zm/upload/Labour_Force_2014/2014_LFS_FULL_FINAL_Report.pdf) (accessed 12 Apr. 2017).

<sup>103</sup> Ibid.

<sup>104</sup> Xinhua (2017), ‘Zambia makes progress towards IMF bailout program: official’, 31 August 2017, [http://news.xinhuanet.com/english/2017-09/01/c\\_136572222.htm](http://news.xinhuanet.com/english/2017-09/01/c_136572222.htm) (accessed 1 Sept. 2017).

vibrant SME sector, including through improvements in the policy and business environment, the implementation of macroeconomic reforms resulting in reduced inflation rates, liberalized trade policies and the removal of foreign-exchange restrictions. The abundance of natural resources can also be exploited through various value-addition activities to give Zambia a competitive advantage.

The *Zambia Business Survey* of 2010 was a first major effort to explore the country's business landscape. It found a clear division between MSMEs – consisting mainly of informal, owner-operated, home-based, income-generating activities rather than formal, clearly structured businesses – and a small number of large businesses that employ only 7 per cent of the labour force but produce the bulk of industrial output.<sup>105</sup> It has been assessed that 81 per cent of MSMEs are based in rural areas, with 70 per cent operating in agricultural production and 21 per cent in retail trade. Virtually all 'large' enterprises are formal and consist mostly of limited liability companies. But most of these are still relatively small. Only about one-third has more than 100 employees and only 2.5 per cent have more than 500 employees.

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Recent reports from multilateral and international financial institutions concur that the headwinds buffeting the economy in 2015 were primarily due to fast-rising expenditure and a fiscal deficit that had more than doubled in 2013. Slowing demand from China reduced copper prices to their lowest level in seven years in 2015/16.

From 2010 to 2016, domestic consumption rose by 6.8 per cent, but the market is driven by demand for very small-scale, fast-moving consumer goods (FMCG). No fewer than 91 per cent of consumers are classified in the 'lowest' segment, spending under \$2.97 per day.<sup>106</sup> Only 7.8 per cent of consumers approach what might be considered middle-class status, spending between \$2.97 to \$8.44. Those in the 'lowest' segment spend around 58 per cent of their disposable income on food and beverages, and account for over three-quarters of that market nationally.

Producers that have adapted to these conditions and tailored their products to the market have been able to do well, but they are highly vulnerable to small changes in their consumers' incomes. When incomes fall, people revert to informal products. For example, National Breweries laid off over 100 workers in September 2016, citing a decline in the profitability of Chibuku Shake Shake beer as more consumers chose to drink cheaper 'opaque beer', which is distributed by informal dealers.<sup>107</sup>

Success in the FMGC market comes from a diverse product range, quality products and recognizable brands that can compete with better-known imports. The largest FMCG company in the country is Trade Kings, which was established in 1995 and two decades later employs more than 6,000 people.<sup>108</sup> It produces over 300 products including detergents, soaps and soya foods, and it also owns a steel

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<sup>105</sup> Clarke, G. R. et al (2010), *Zambia Business Survey: The profile and productivity of Zambian businesses*, <http://documents.worldbank.org/curated/en/949481468170956721/pdf/698090v-10ESW00ivity000final0report.pdf> (accessed 15 Feb. 2017).

<sup>106</sup> World Bank (2017), 'Consumption: Zambia', Washington, DC: World Bank, <http://datatopics.worldbank.org/consumption/country/Zambia> (accessed 12 Apr. 2017).

<sup>107</sup> *Zambian Observer* (2016), 'More Lose Jobs at Zambia Breweries', 8 September, <http://www.zambianobserver.com/more-lose-jobs-at-zambia-breweries/> (accessed 12 Apr. 2017).

<sup>108</sup> Sutton, J. and Langmead, G. (2013), *An Enterprise Map of Zambia*, London: International Growth Centre.

plant. Sixty per cent of its sales are in the domestic market and 40 per cent are exports. The company has invested in advertising and brand promotion, as well as in improving packaging quality, which gives it a competitive advantage. Group Director Bright Chunga states that part of this success is due to its skilled workforce. The company benefited from highly skilled personnel who were looking for work after four major multinationals in the sector pulled out of ‘non-performing Zambia’ following mass privatization in the 1990s.<sup>109</sup>

Other producers have similarly targeted the ‘lowest’ consumer group. One example is Speciality Foods, which has a turnover of approximately \$3.6 million a year and employs 150 people.<sup>110</sup> Its business model is adding value to locally sourced produce, and then selling in small units that suit the low-income market. The company had benefited from the entry of multinational retailers, such as Shoprite, into Zambia as these supermarkets purchase local products to sell in their stores. Another company that is successfully processing local produce is Amigo, which produces crisps and snacks. Between 50 and 60 per cent of its inputs are sourced locally, and the company employs around 200 staff. Its share of the domestic crisp market is around 50 per cent, and 40 per cent of its traced sales are through informal traders.<sup>111</sup>

Successful small businesses can increase their sales volumes by exporting to the regional market. Speciality Foods exports a small number of products, largely to the neighbouring DRC. Amigo exports 6 per cent of its products, but it has also set up distribution channels in Malawi and Zimbabwe. The regional market gives Zambian producers access to a large consumer pool, and the government is committed to regional economic cooperation. Zambia participates actively in the Southern African Development Community (SADC) and the Common Market for Eastern and Southern Africa (COMESA) free-trade areas. It has also affirmed its commitment to participating in interregional trade with the East African Community (EAC), and to forming a COMESA-EAC-SADC free-trade area with a combined population of 632 million and a total GDP of \$1.3 trillion.

## Agri-processing

Agricultural productivity in Zambia is low and in decline. Its contribution to GDP value-added has fallen from around 17 per cent in 1999 to under 10 per cent in 2014.<sup>112</sup> The Lusaka-based Indaba Agricultural Policy Research Institute argues in favour of increased investment, research, commercialization and increased productivity. But its researchers also contend that there is a considerable opportunity for the private sector to demonstrate its potential and success to members of the government and civil service who still regard the state as the most important driver of rural transformation and agricultural success.

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<sup>109</sup> *Business Year* (2015), ‘Drops Make an Ocean’, <https://www.thebusinessyear.com/zambia-2015/drops-make-an-ocean/interview> (accessed 12 Apr. 2017).

<sup>110</sup> Sutton J., and Langmead, G. (2013), *An Enterprise Map of Zambia*, London: International Growth Centre.

<sup>111</sup> *Ibid.*

<sup>112</sup> Zulu, B., Chapoto, A., Nkumbula, N. and Mulenga, K. (2016), *Economic Diversification in Zambia: Agriculture Leading the Way*, Lusaka: Indaba Agricultural Policy Research Institute.

State intervention in agriculture is high, and the government plays an important role in supporting rural livelihoods. It provides subsidies under the Farmer Input Support Programme to farmers at the bottom of the scale who are unable to get finance elsewhere. The Food Reserves Agency (FRA) provides further support by purchasing maize from the same farmers at a guaranteed price. The FRA has considerable buying power in the maize market, purchasing upwards of one-third of the national harvest.

However, these programmes have failed to achieve a reduction in poverty levels or to improve productivity. Together, they have accounted for between 37 and 60 per cent of the agricultural budget over the past decade – money that might have had a greater impact if it had been invested in broadening market access.<sup>113</sup> Furthermore, government policy has led to the crowding out of cash and export crops such as cotton, cashews and soya beans.<sup>114</sup>

Despite these market distortions, there is great potential in agriculture and agri-processing in Zambia. This is something the new government is actively seeking to promote. The approved budget for 2017 outlines greater incentives for agribusiness and rural development. This includes plans to promote diversification into cash crops, such as through a Cashew Nut Infrastructure Support Programme, an Emerging Farmers Support Programme and training for farmers in fish-feed production.

At a discussion at Chatham House in 2017, Minister of Finance Felix Mututi encouraged further international investment in the agricultural sector.<sup>115</sup> He highlighted that significant international investment in a company called Real Meat, which he identified as the ‘next Zambeef’, had helped that company to grow. He also stated that there is now positive competition. But the minister also acknowledged that access to finance remains a barrier to upscaling for many small producers.

## Obstacles to growth

In 2015, the financial sector had 19 registered commercial banks and more than 30 microfinance institutions. The commercial banking sector is reasonably well capitalized. Nonetheless, according to the business survey conducted in 2010,<sup>116</sup> SMEs considered limited access to finance a serious constraint to their operations. This concern was particularly prevalent among microenterprises and farm owners. All current analysis indicates that this situation has improved only marginally.

The lack of access to adequate financial services is a serious obstacle to the performance of MSMEs, which needs to be urgently addressed if companies are to be helped to grow and become sustainable. Equally, lack of access to financial education is particularly important for SME development.<sup>117</sup> Banks such as Barclays, Stanbic and Zanaco have financial education programmes for SMEs, while at the same time educating their own staff to better understand the circumstances of smaller clients. The Bank of Zambia has put together the Unified Collateral Registry, which will allow SMEs to access funding using other forms of movable property as collateral security. Other noteworthy recent

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<sup>113</sup> Kuteya, A., Sitko, N., Chapoto, A. and Malawo, E. (2016), *An In-depth Analysis of Zambia's Agricultural Budget: Distributional Effects and Opportunity Cost*, Lusaka: Indaba Agricultural Policy Research Institute, p. 11, <http://fsg.afre.msu.edu/zambia/wp107.pdf> (accessed 12 Apr. 2017).

<sup>114</sup> Ibid.

<sup>115</sup> Mutati, F. (2017), ‘Zambia's Financial Stability and Prospects for Growth’, speech delivered at Chatham House: The Royal Institute of International Affairs, 24 February 2017, <https://www.chathamhouse.org/event/zambia-s-financial-stability-and-prospects-growth#sthash.qRfSZfRn.dpuf> (accessed 12 Apr. 2017).

<sup>116</sup> Conway, P. and Shah, M. K. (2010), *Zambia Business Survey: Who's productive in Zambia's private sector? Evidence from the Zambia Business Survey*, [http://siteresources.worldbank.org/INTAFRICA/Resources/zambia\\_biz-survey.pdf](http://siteresources.worldbank.org/INTAFRICA/Resources/zambia_biz-survey.pdf) (accessed 15 Feb. 2017).

<sup>117</sup> Gray, A. (2012), *Access to finance for inclusive business in Zambia*, Bonn: Inclusive Business Action Network, <http://www.inclusivebusinesshub.org/access-to-finance-for-inclusive-businesses-in-zambia/> (accessed 15 Feb. 2017).

advances include the expansion of the Credit Reference Bureau, as well as new methods for assessing the creditworthiness of small entrepreneurs seeking unsecured loans. Better access to finance may not be very helpful unless a business is ready for investment with secure legal, commercial and financial foundations as well as a sound business plan. In 2017 the government plans to establish an Agricultural and Industrial Credit Guarantee Fund for SMEs to facilitate access to affordable financing.

Zambia is behind the trend in comparison with East Africa when it comes to mobile financial penetration, but that space is being filled with other innovations. Over 80 per cent of adults are unbanked, while around 50 per cent do not have access to mobile communications, so the potential for mobile banking to increase financial penetration is limited. One company that has successfully positioned itself in this space is Zoona, which operates a mobile-money model through the use of agents at kiosks around the country. Not only is this expanding access to financial services, but the firm is also generating employment by hiring kiosk operators.

Investors have at times been deterred by the structural constraints of inadequate infrastructure, uncertain energy supply, and low levels of information and communications technology and skills, as well as some institutional weaknesses. One interviewee from a multinational South African retailer complained that it takes only three days to get a container from the dock in Cape Town to Johannesburg, but three weeks to transport the same container from Johannesburg to Lusaka.<sup>118</sup> Furthermore, in a recent interview, Trade Kings CEO Bright Chunga estimated that production at the company's steel plant fell to 30 per cent of installed capacity due to load shedding in April 2016. He noted: 'We had a turnover of \$12 million per month in terms of what we were producing and what we were selling. Now, it has come down to \$3 million.'<sup>119</sup>

The importance of commodity prices for and economic growth, as demonstrated in recent years, highlights the urgent need to diversify the economy. While it is expected that higher copper prices will over the longer term ease the strain on the economy, the government will need to deliver on its wide-ranging plans for diversification if the economy is to build up resilience against the uncertainties of commodity markets. Positive policy will encourage business, and this will be supported by infrastructure developments such as new power plants.

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<sup>118</sup> Interview, Johannesburg, June 2016.

<sup>119</sup> *Post* (2016), 'Load-shedding cuts turnover of Trade Kings by 70%', 22 April 2016.

## 6. Conclusions

This paper set out to answer the question of why there are so few rapidly growing mid-sized companies in sub-Saharan Africa, and how can this be remedied. There is, of course, no single answer, not least because the vast cultural, political and geographic diversity of African states precludes any easy generalizations. In each of the countries surveyed – Nigeria, Tanzania, Uganda and Zambia – interviewees were asked broadly the same set of questions, looking for examples of businesses succeeding or failing, and exploring the context and details around those experiences. Some core constraints to business growth were uncovered across these four countries, including limited access to finance, poor infrastructure, a constrained pool of skilled workers, and corruption.

There are stark differences in context, too. Nigeria is very different to the other three countries. The Lagos conurbation alone comprises some 21 million people, far more than the entire population of Zambia. The city is an emerging regional finance hub, and is certainly on a different scale to Lusaka, Dar es Salaam or Kampala. Likewise, while Lagos-based entrepreneurs can rely on a huge base of Nigerian customers, Uganda's businesses are forced to engage with an extremely volatile regional market. South Sudan, for instance, has historically been a source of significant revenues for Ugandan firms, but the recent outbreak of civil war there also led to large losses for Ugandan investors.<sup>120</sup> At the same time, large Kenyan companies are also increasingly competing for regional market share.

### Barriers to investment

It is possible to draw some generalizations around the macro context within which African businesses operate, and about common ambitions for growth. First, there was a consensus among interviewees that reaching scale would be transformative, for individual businesses and countries alike, in sectors such as decentralized energy and agribusiness, and in social enterprises, not least in generating formal employment. Furthermore, while identifying finance and human capital as barriers to scale in each of the four countries surveyed, it was agreed that the flow of more money in the market in search of investment opportunities, together with more investment in human capital, would be unlikely, in the absence of a supportive environment for business, to be sufficient to completely dismantle these barriers.

Africa's formal economies are still predominantly geared to exporting raw materials. Improving the level of value-added local production would require the start-up of new businesses, or for established businesses to diversify their production. Africa is home to some 15 per cent of the world's population, yet in 2015 the continent received only 3.1 per cent of global FDI.<sup>121</sup> A very significant portion of investment going into sub-Saharan Africa goes into primary extractives, for the simple reason that this is where banks expect better returns.<sup>122</sup> Money thus flows into economies with cheaper labour, more developed and efficient infrastructure, and more predictable business environments.

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<sup>120</sup> Media reporting puts the value of lost formal trade between Uganda and South Sudan in 2016 at \$265 million. Informal trade values are much harder to quantify, but are likely to be substantial. This has led to a drop in GDP and lower tax takes. *African Business* (2017), 'Uganda counts its losses in South Sudan', January 2017, <http://africanbusinessmagazine.com/region/east-africa/uganda-counts-losses-south-sudan/>.

<sup>121</sup> United Nations Conference on Trade and Development (2016), *World Investment Report*, Geneva: United Nations Conference on Trade and Development, [http://unctad.org/en/PublicationsLibrary/wir2016\\_en.pdf](http://unctad.org/en/PublicationsLibrary/wir2016_en.pdf) (accessed 15 Feb. 2017).

<sup>122</sup> Extraction was the largest business area in terms of capital investment into Africa in 2015, making up 23 per cent of FDI. *Analyse Africa* (2016), *The Africa Investment Report 2016*, London: Analyse Africa.

African countries trying to increase formal employment are faced with a dilemma. They are typically trying to find a balance between developing exports of hard commodities to underpin government revenues, and focusing on soft commodity value chains that link commercial agriculture to exports as well as supplying the national market. The key to building an optimal outcome is infrastructure – a fact that has been recognized by governments and donors alike, and which has led to the current emphasis on FDI going into infrastructure.<sup>123</sup>

However, infrastructure, while important, is not on its own a ‘magic bullet’ for business growth. Some of the barriers presented by infrastructural weakness are more political than logistical. Roadblocks, for instance, are a feature of African life. It is not unusual to find them every five or so kilometres on some major roads of economic importance. These impact significantly on transport times and impose major costs. For example, studies suggest that it should be possible to travel the 1,000-km road between Kano and Lagos in 14 hours, but the journey in reality takes 48 hours, with roadblocks cited as a major cause of delay.<sup>124</sup>

The relative weakness of banks is another common feature across many African economies. As noted above, banks are frequently criticized for being risk-averse. While they are required to protect the interests of their shareholders, it is also in their interests to grow their capital. SMEs clearly carry more risks and absorb more management time for banks than do larger companies, but they will be the engine of growth in many places, and thus also constitute significant investment opportunities. The view from the African Development Bank was summed up by one country director:

When we extend a line of credit to the [national bank], we do it at no more than 5 per cent. But when they lend to small businesses they do so at market rates, which can be as high as 20 or 30 per cent. This is very constraining for SMEs.<sup>125</sup>

Research for this paper found commercial banks charging between 25 and 48 per cent, compared with government banks applying interest rates as low as 9.5 per cent.

Despite the relative success of microfinance systems, mass consumer credit has not taken off in Africa. For example, less than 1 per cent of Nigerians who have bank accounts also hold credit cards.<sup>126</sup> One interviewee commented that, despite a perception among some Nigerians that there is no large mercantile class of people with wealth who are looking for investments, or no large group of people who can place their savings into local banks in volume, in reality, interest rates are low for savings and high for loans. They observed that ‘capital flight occurs for a reason’.<sup>127</sup>

## Formal and informal

Counter to the pessimistic view is the fact that in Africa ‘informal’ does not mean ‘small’. The informal economy is big business, and the International Labour Organization estimates that it makes up 41 per cent of GDP in sub-Saharan Africa.<sup>128</sup> The informal sector in Zambia, for example,

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<sup>123</sup> To put the FDI into African infrastructure into context, expatriate Africans send home around \$40 billion a year, compared with some \$50–55 billion in annual FDI. Both figures are eclipsed by capital flight, however.

<sup>124</sup> Interviews, Lagos, October 2016; and Coste, A. (2014), *Domestic obstacles to trade and transport in Nigeria and their impact on competitiveness*, Washington, DC: World Bank.

<sup>125</sup> Confidential telephone interview, November 2016.

<sup>126</sup> Kiruga, M. (2016), ‘Credit cards in Africa: continent lagging behind ... but that’s great potential right there’, *Mail & Guardian*, 10 May 2016, <http://mgafrica.com/article/2016-05-10-credit-cards-in-africa-continent-lagging-behind-but-thats-great-potential-right-there> (accessed 23 August 2017).

<sup>127</sup> Interview, Lagos, November 2016.

<sup>128</sup> See, for instance, Jackson, T. (2016), ‘Why the voice of Africa’s informal economy should be heard’, London: London School of Economics, <http://blogs.lse.ac.uk/africaatlse/2016/02/17/why-the-voice-of-africas-informal-economy-should-be-heard/> (accessed 23 August 2017).

employs 85 per cent of the labour force and has grown rapidly in recent years, constituting more than 1 million informal businesses.<sup>129</sup> Africa's larger provincial villages typically have one or two traders or storekeepers who each have a sizeable turnover – and who trade with cash.

Extending formal financial services to those traditional businesses could begin to bolster the overall banking sector, draw the banks' interests closer to those of SMEs, and lead to greater levels of effective taxation. In Zambia, for instance, informal market systems, predominantly unregistered, unregulated and untaxed, have wider geographic coverage, more depth and greater social integration than the formal system.<sup>130</sup> However, such informality presents a challenge to retail banks and external investors alike.

Many informal businesses in Uganda – even those that generate a substantial turnover – are run along family lines, are often driven by an individual, tend to hold incomplete records, and can suffer shortfalls in management of finances and human resources.<sup>131</sup> These factors mean that it is very difficult for lenders to assess the chances of a loan default or to make an accurate assessment of likely returns on investment. They thus remain cautious and hedge against risk through high interest rates, even when there is capital available. There is also the question of how to 'formalize' businesses, where there are few, if any, incentives for family-owned and -operated companies to deal with the formal finance institutions.<sup>132</sup>

This issue is even more acute in relation to agriculture. In a country such as Uganda, where the sector is dominated by smallholders who rely heavily on natural inputs and very often lack the formal title to their land, agricultural loans are a very risky proposition for lenders. Irrigation and fertilizer use are low, and farmers are highly exposed to worsening variations in climatic conditions and have little collateral to guarantee a loan.<sup>133</sup>

## The policy challenge

Finding policies that integrate the interests of business, banks and policymakers is not easy. Supporting national banking sectors may be one place to start. It may also be fruitful for external investors to consider targeted, strategic investment in key catalytic industries where the local market has failed. There is, for instance, no Ugandan fertilizer production, and import prices are out of reach for the majority.<sup>134</sup> Thus, a relatively small investment there could have a significant transformative effect.

Moves by banks to change their practices may be propelled by changes in the way people 'do' finance. Africa's extremely fast uptake of mobile phones is being followed up by a similarly rapid expansion of mobile banking. A factor perhaps more important than banking is that the transformation in communications brings with it 'free' technical education, precise market information and credible market analysis. As a result, African entrepreneurs are beginning to use cheap transnational communications and social media to leverage crowdfunding, as well as making use of 'decentralized' currencies such as bitcoin to lower their costs.

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<sup>129</sup> Central Statistical Office and Ministry of Labour and Social Security (2013), *2012 Labour Force Survey Report*, Lusaka: Central Statistical Office.

<sup>130</sup> Interviews, Lusaka, August 2016.

<sup>131</sup> Interviews, Kampala, October 2016.

<sup>132</sup> Interview, Lagos, November 2016.

<sup>133</sup> Interviews, Kampala, October 2016.

<sup>134</sup> Interviews, Kampala, October 2016.

What drives demand for finance is vision, essentially meaning people with ideas – and the requisite skills – who want to grow a business. And what helps people secure the backing of a loan is knowledge: the ability to solve problems and demonstrate competence. In Uganda, for example, the problem is not so much lack of finance, but a shortage of ‘investible’ firms, in the context of a nascent business culture and underinvestment in accessible business-development training. But while business schools are a rarity in Africa, online education may be an alternative. Anyone with internet access can enrol, at no cost or for a nominal fee, on courses run by the world’s top universities. For students in sub-Saharan Africa, the courses of choice are computing, finance, business management, business development and project management.<sup>135</sup>

## Empowering entrepreneurs

In Nigeria there is a moneyed entrepreneurial class that sees an imperative in working with Africa’s dominant economic group – small-scale farmers – in creating the kind of change that will feed the continent. The members of this class are not farmers, but rather professionals from other areas – including finance and law – who want to commercialize farming. While they say they want to return a profit, one common factor is linking farmers to markets in ways that raise farm-gate prices and bring benefits to producers. The other common factor is the use of information technology.

Uganda, on the other hand, has a relatively small entrepreneurial class – despite a good regulatory environment, access to regional markets and strides made in basic infrastructure in recent decades. In part, this is because many local markets are dominated by ‘apex’ companies that have often been present in Uganda for a significant period. Much of the rest of the available market share is taken up by individuals with access to private finance, or by foreign investors. There are thus significant barriers to local entrepreneurs seeking to break into these protected markets.

Resources such as the World Economic Forum’s Enabling Trade Index and the World Bank’s annual *Doing Business* rankings provide useful indicators of the private-sector operating environment in each of the countries surveyed for this paper. But they do not tell the whole story, and cannot capture the nuanced realities of founding and growing a business in any one of the four. Nigeria, for instance, has latterly moved up a couple of points in the World Bank’s rankings, partly because of the ability to register a company quickly online. However, one entrepreneur related their own experience as follows:

To register my business I had to fill in an online form. I then had to print the form out, take it to the office. The first time the application was refused because they needed the receipt from the transaction. I printed that off and presented my application again. Then they needed a passport photo, not the digital one on the online application, but an original. I got this and presented my application again but the office was closing. It took four trips to the office to present what was already in their computers. That was in July and I still have no response. I can phone the office or go there, but they cannot really answer my questions. Getting an export licence is also very slow. It can be done, but it’s slow.<sup>136</sup>

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<sup>135</sup> Harvard X (undated), ‘World Map of Enrollment’, <http://harvardx.harvard.edu/harvardx-insights/world-map-enrollment> (accessed 15 Feb. 2017).

<sup>136</sup> Interview, Lagos, November 2016.

One further point of commonality between the four countries was the widely expressed need to minimize contact with the state, either by remaining small and informal, or by using innovative technological means to sidestep bureaucracies and their attendant rules and delays. There is, for instance, a growing appreciation that the internet can be used to transfer funds between countries.<sup>137</sup> Because foreign-exchange controls restrict the capacity of companies to import goods from overseas, small- and mid-scale Nigerian importers have begun using bitcoin as a trading currency through the Nairobi-based BitPesa platform. The system has the potential to significantly streamline and reduce costs when money moves between businesses, and to circumvent foreign-exchange controls in a relatively low-risk manner.<sup>138</sup> The spread of broadband also brings in the prospect of African entrepreneurs using crowdfunding to finance start-ups and to get existing companies ‘on the step’. Examples of such crowdfunding are still rare, but are growing nonetheless; and, while many have failed, there are a few, like Startcrunch.com, that are hanging in there.

The information transfers enabled by mobile connections may also be transformative for agriculture. One Nigerian farmer interviewed, for instance, talked about the development of a mobile app that provides daily market information in the form of commodity prices for the 50 or so main agricultural crops in the major urban markets across Nigeria. Such information allows farmers to choose the right markets for their goods and negotiate with the aim of achieving better prices.<sup>139</sup> A similar situation was found in interviews with farmers, policy researchers and risk-insurance specialists in Zambia, where a vision to empower and include small farmers in the production chain for self-reliance and higher profits was a common thread. There, the ambition was to commercialize farming so as to empower farmers, feed the growing urban population and ensure national food security. Finding ways of supporting this African-led movement should be a high priority for anyone involved in development finance.

While the political leaders of sub-Saharan African countries are still predominantly old, the pattern is apparently changing. The generation now coming to power is that of politicians born after independence. Its members are typically urban and highly educated. While their parents worked in the professions or as top-level civil servants in their home country, a portion of the new generation have headed for the private sector abroad, gaining high-quality MBAs and moving into global finance and management-support sectors before returning to Africa.

Many of the interviewees represent a new generation of urban African entrepreneurs who are networked instantly, particularly through mobile technology, like their peers globally. Among them, and especially in Lagos, there was a sense of collective ‘ownership’ of the future. Comfortable with Western codes and norms, local entrepreneurs want to make Africa work on their terms. As members of this generation inevitably come closer to political power, and as they understand more about the drivers of development, it could be assumed that many of the policy constraints would dissolve. Yet there remains tension between the rapidly growing needs of the people and the political will to unlock the barriers to private-sector growth. If governments do not act fast to make real space for the new entrepreneurial cohort, they risk failing their growing populations.

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<sup>137</sup> Google Trends illustrates interest in any search item – including bitcoin – and shows search volume by country and sub-region.

<sup>138</sup> If proxy data from Google Trends are an indicator, Nigeria trading volume would be on par with Kenya. See Coin Dance (undated), ‘LocalBitcoins Volume (Kenya)’, <https://coin.dance/volume/localbitcoins/KES>.

<sup>139</sup> Including Fasmicro’s Zensus, see <http://zensus.com>.

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