

# Private Sector Development in Sub-Saharan Africa



Thesis of Danielle de Wit  
20057824  
Class 4BB  
Thesis supervisor: Mr. Parlevliet  
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Haagse Hogeschool

## i Executive summary

Sub-Saharan Africa (SSA) is an underdeveloped region, but had seen significant economic growth before the global financial crisis. Due to the crisis economic growth has stopped or even decreased. In addition, several other aspects are expected to become worse, such as incomes, child mortality and access to water.

To create prosperity by economic growth private sector development is needed. After the failure of the state-owned enterprises in the former colonial states, privatization became increasingly important. Two approaches are seen as important backgrounds of the thinking around private sector development: the neoclassical and the neo-structural approach. The latter approach follows the idea, in contrast to the neoclassical approach, that governments have to interfere when they see that the situation of the market is worsening. There are various theories about how to develop the private sector. The most recent theories concerning this subject are developed by: the United Nations by the Millennium Development Goals; Dambisa Moyo who argues that aid must be stopped, Jeffrey Sachs who wants to end poverty by 2025 due to individual treatment of states, Prahalad by investing in the bottom of the theory, and Hernando de Soto by giving the poor their property rights. Research into the situation of the private sector in developing countries and developed countries is conducted by various organisations, such as the World Bank, the International Monetary Fund and the World Economic Forum.

Small and medium enterprise (SME) development in SSA arose during the 1980s due to the poor economic situation worldwide which caused an increase in the number of SMEs in Africa. There are differing opinions regarding small and medium size enterprise development. There is the so-called pro-SME view and a sceptical SME view. Clearly, the advocates of the pro-SME view believe that SME development is needed, because SSA's economy needs a developed SME sector to create, for example, employment. The sceptical SME view approaches private sector development from the side of the large enterprises, which do not understand the necessity of the use of smaller enterprises to create economic growth. Entrepreneurs of SMEs in the region have to deal with several constraints to their businesses. These are governmental and financial issues, lack of electricity and infrastructure. Both men and women face these constraints. Yet, women entrepreneurs defy even more constraints when starting a business in the SME sector: inequality issues, lack of access to education and healthcare, lack of cultural acceptance, financial issues and constraints to expand a micro-enterprise into a SME.

The problems for both men and women entrepreneurs in the SME sector are clear. However, there is not one unburdened solution to their problems. There are theories which claim they can solve all manner of problems in the private sector in SSA. Clearly, a solution must

be found for the governmental, financial and infrastructural problem in SSA. Yet, nobody knows what will eventually work for SMEs in this region.

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## 1. Introduction

Private sector development (PSD) is a rather new form of economic development in Africa. In the mid 1980's the Western world started putting their ideas, of reducing poverty and economic growth simultaneously, into practice. By means of PSD Sub-Saharan Africa could be a focus for innovative technologies and financial resources (Wortman, 1992, p.14).

In media and politics development cooperation is a much-discussed subject. Because of the international financial crisis the discussion about the effectiveness of development cooperation and its budget, the subject has become extremely significant. Most enterprises in Africa are Small and Medium Enterprises (SME's). Economic growth is a highly important factor for a country which wants to rebuild its economy. SMEs are promoted as being the answer to issues with developing Third World Countries, by governments and other institutions, because they can bring social and economic development. In the Netherlands, organisations such as BiDNetwork, are very active in localising potentially successful entrepreneurs in developing countries and try to connect them to investors. They see chances for emerging markets and stimulate economic growth in these countries, because sustainable entrepreneurship and investing in local economies can provide, amongst other advantages, employment ('Preparing emerging market entrepreneurs for investors', 2009, para. 1). These organisations prove that reducing poverty and making profit can go hand in hand. The United Nations Industrial Development Organization (UNIDO) believes that 'small-scale manufacturing enterprises can play a key role in triggering and sustaining economic growth and equitable development in developing countries'(Ceglie, Dini, 1999, para.1). However, this potential role is often not fulfilled because of several diverse problems SMEs have to deal with.

Especially in Sub-Saharan Africa, the poorest region in the world, the sector where SMEs are active is still underdeveloped. This is reflected by, among others, limited pro-poor growth. A more equal division of wealth could be generated by a flourishing middle class. Therefore, the central question which will be treated in this thesis is: Why do countries in Sub-Saharan Africa not succeed in developing their SME sector? Before being able to respond to this central question these sub-questions need to be answered: What is Private Sector Development? Secondly, 'What is SME development and what are the main issues of entrepreneurs in Sub-Saharan Africa?' This thesis is deskresearch of the available literature of private sector development of SMEs in Sub-Saharan Africa. This thesis attempts to explain the economic situation of Sub-Saharan Africa (SSA), will give background information of the situation entrepreneurs have to deal with and the term private sector development (PSD) will be further clarified. Various theories about the subject will be presented in this chapter as well. Secondly, the role of SMEs will be further explained and the issues of both male and female entrepreneurs in the region are enlightened. This thesis does not

intent to offer a solution to the issues Sub-Saharan African entrepreneurs face. It will give an overview of the challenge the global community faces in developing the Third World. Even if one does not consider the solution that generates economic growth.

## 2. Private sector Development in Sub-Saharan Africa

### 2.1 The economic situation of Sub-Saharan Africa

Sub-Saharan Africa is a region with more than 780 million inhabitants. The annual population growth is 2.5%. These people live on a surface of approximately 24000 square kilometres. Their life expectancy is not much more than 50 years ('Regional Brief', 2009). The illiteracy rate of young women between the age of 15 and 24 is still 65% in this region. Sub-Saharan Africa is the poorest region in the world. Most of the region's countries are classified as 'lower income economies'. That is a Gross National Income (GNI) per capita of \$825 or less. Angola, Cape Verde and Swaziland may count themselves to the lower income economies (\$826-3,255). Even a few countries belong to the group 'Upper middle income economies' with a GNI per capita between around \$3,000-10,000. Unfortunately, not one of sub-Saharan Africa's countries belongs to the 'high income economies', which have a GNI of over \$10,000 ('Sub-Saharan Africa', 2006).

Africa has to deal with the negative consequences of the global economic crisis ('Regional brief', 2009). Especially emerging markets in Africa were affected by the financial crisis, because of their linkages to other states, internationally. Ghana and Kenya for example, had to deal with 'falling equity markets, capital flow reversals and pressure on exchange rates', according to the International Monetary Fund in its latest report from the African Department on the 'Impact of the Global Financial Crisis on Sub-Saharan Africa' (2009, p.3). Of course, all countries in Sub-Saharan Africa (SSA) are affected by the crisis which has a negative impact on several aspects, such as household merits and export profit. As appears from IMF, '1 percentage slowdown in global growth has led to an estimated ½ percentage point slowdown in Sub-Saharan African countries' (2009, p.3). Burundi and Guinea-Bissau are countries in a fragile social and economic situation. Their financing is likely to be affected due to the crisis. In developed countries the crisis has had a significant impact on the financial sector. In developing countries this is not the case, because of the few connections with banking systems outside Africa. Nevertheless, this does not mean that banks are not at risk if the crisis continues (IMF, 2009, p. 3-4).

What is the impact of the crisis in figures? GDP growth has declined by 60%. Four subjects are especially subject to the crisis, according to the World Bank, private capital flows declined by 40%, there was a decline of remittances and official development assistance stopped or declined which also counts for export revenues. Child mortality under a year old could increase by 700.000. Certain countries may not be able to reach the first millennium development goal of reducing poverty by half in 2015. Access to water, food and credit are at risk to decline as well. Thus, not only is the first Millennium Development Goal (MDG) not very likely to be achieved, but others as

well (World Bank, 'Regional brief', 2009). The Global Monitoring Report from The World Bank has calculated that the financial crisis will cost the poorest people in SSA \$18 billion. The percentages of income drops are much higher in SSA than in western countries. The poorest will see their income decrease by approximately 20%. According to the World Bank, countries in this region will need more capital to overcome this bad economic situation. The states which provide this capital also suffer from the crisis and the budgets for international cooperation will be reduced, because of the fact that these budgets are expressed as a share of GDP (Global Monitoring Report, 2009, p. 25-31). Yet, worldwide support, for global development, trade and wellbeing will be extremely important for the continent, according to IMF (IMF, 2009, p. 10).

The figures above mentioned might not seem promising. However, since the 1990s Africa's economy has been growing. In 2007, GDP growth reached the highest point, 6.9%. From the beginning of the 21<sup>st</sup> century private capital flows in Sub-Saharan Africa have increased and reached \$53 billion in 2007. As a result, economies were reinforced which again resulted in 'fiscal consolidation, reduced deficits, lower inflation rates and improved business environment', increased political stability and democracy, according to the working paper of the Overseas Development Institute: 'The global financial crisis and Sub-Saharan Africa' (2009, p. 2). Moreover, economic growth attracted other growing emerging markets as well, such as China (ODI, 2009, p. 2-3). In 2007, Eurostat shows that the European Union had a real GDP growth of 2.9% which is, evidently, much lower than SSA's GDP growth ('Real GDP growth rate', 2009). Although SSA had a high economic growth rate compared to the EU, it cannot be denominated as 'pro-poor growth'. Pro-poor growth is the kind of growth that reduces poverty. Just a small amount of people in SSA can enter the formal economy, although their informal economy is quite large. Therefore the potential of economic growth is exceedingly low.

Thus, Sub-Saharan Africa is an underdeveloped region, but had seen significant economic growth before the global financial crisis. Due to the crisis economic growth per country has stopped or even decreased. In addition, incomes, child mortality and access to water are expected to decrease as well.

## 2.2 Private Sector Development and its importance

It is a general belief throughout the world that economic growth can be achieved by an energetic and competitive private sector that creates prosperity and employment. The private sector is in the 'possession' of entrepreneurs in a society without interference of the government. 'Measuring performance in private sector development', a book from the Asian Development



Bank, defines PSD as follows: ‘....developing an enabling business environment or investment climate’ (Hood, 2007, p. 4).

As earlier mentioned in this thesis, in the eighties of the previous century, private sector development became more and more important for both developing and developed countries. A question which is important in the light of this subject is why private sector development became such an important subject. Before the eighties, the private sector was very small in Africa. Most enterprises were state-owned, therefore the public sector was very large. Public ventures were established at that time by colonial powers to, according to Dinavo, ‘cover their own generated costs’ (1995, p.52). Since the 1950s, developed countries recognized that the market systems did not generate economic growth in the developing world. Their reaction was to follow the ‘interventionist approach’, which means that it was generally believed that the government should intervene in this failing economic situation in order to eventually solve the problem. Consequently, the public sector became even larger. Unfortunately, the interventionist approach did not cause economic growth in developing countries (Dinavo, 1995, p.51-53). According to Dinavo there are various explanations for the failure of state-owned enterprises, such as ‘poor performance, low quality of goods and services, misallocation of resources and lack of managerial skills’ (1995, p.54). Therefore, the concept of privatization became more appealing (Dinavo, 1995, p.54).

There are two significant diverse approaches to privatization, or private sector development: the neoclassical approach and the neo-structuralist approach. Dinavo describes the neoclassical approach as an idea that ‘emphasizes and encourages the reduction of the size of the public sector, removal of government controls and regulation and promotion of competition’ (1995, p. 54). The role of the public sector is very limited, according to this approach. Government can interfere in the private sector if it is clear that the market is failing. Supporters of the neoclassical approach believe that government intervention should be eliminated and property rights and competition should be guaranteed. Hence, the economic situation will ameliorate. The proponents of the neoclassical approach support the ideas of Hernando de Soto, who wrote about his theory to end poverty in his book called ‘The mystery of capital’. More detailed information about his ideas will be given further on in this chapter. The World Bank and other international organisations and institutions also believe that governments should not intervene in the private sector and its performances.

On the other hand, there is the neo-structuralist approach. ‘Analysts from a neo-structuralist or evolutionary background stress the role of additional determinants in explaining private sector dynamism, and especially the ability to upgrade and build knowledge-based competitive advantages’, according to the United Nations Industrial Development Organization (2008, p. 8). In contrast to the neoclassical approach the proponents of the neo-structuralist approach believe that

governments have to interfere when they notice that the situation of the market is worsening. Yet, 'just providing the basic market institutions' (UNIDO, 2008, p.10), is not the answer to generate growth and end poverty. What is important for neo-structuralist proponents is, 'to find the right balance between measures designed to unleash market forces and to correct market failures' (UNIDO, 2008, p. 11).

Some might question the combination of making profit and reducing poverty. The answer to that question is 'job creation', according to Warrick Smith, the author of 'Unleashing Entrepreneurship' (Brainard, 2006, p.31). Ninety percent of all jobs in developing countries are created by the private sector. Smith says that poor people even appointed job creation as one of the most important factors of enhancement of their economic and social situation (Brainard, 2006, p.31). Private sector development has, generally, become more and more essential for international cooperation and sustainable development. Companies and particularly small and medium-size enterprises play a central role in alleviating poverty and developing economic opportunities for developing countries. In the eighties of the twentieth century, private sector development became increasingly important in the developing sector worldwide. The focus during this period was mainly set on macroeconomic policy and SME credit. In the 1990s, the target of organisations and governments was to enhance businesses with, for example, microenterprises. In recent years people have added social aspects to private sector development, such as health, education and family. Moreover, development of the private sector also has an impact on employment, environmental issues and human rights (Brainard, 2006, p. 108).

In 2000 the Millennium Development Goals (MDGs) of the United Nations were drawn up by the Millennium Declaration and are subscribed by 189 countries. These goals are formulated to help the world's poorest out of poverty and to create a better world. The eight goals are to be achieved by 2015. Also the MDGs highlight the importance of private sector development in developing countries. As Koffi Annan has said: 'We cannot reach these goals without the support of the private sector. Most of all, we cannot reach them without a strong private sector in the developing countries themselves, to create jobs and bring prosperity' ('Annan launches new UN-private sector alliance to fight poverty, AIDS, illiteracy', 2003, para. 3). There are still a lot of people who have to live of 1 US Dollar per day. The first millennium development goal states that this problem needs to be solved by means of, among others, decent employment for all people including women ('About the MDGs: Basics'). The improvements in the living standards of certain Asian countries are proof that such a goal can be effective. An example of a country which has experienced an immense development is China. Around 400 million inhabitants of the country are now living above poverty standards as a result of economic growth (Brainard, 2006, p.2). Other

countries that have gained a lot of economic successes are El Salvador, Vietnam, Latvia and Uganda (Brainard, 2006, p. 29).

During the last decade there has been a public discussion about the effectiveness of international cooperation and aid. There are several opinions about how developing countries can get out of poverty. Dambisa Moyo, an economist from Zambia who has studied at the universities of Harvard and Oxford and former specialist of Goldman Sachs in Sub-Saharan Africa, has caused some commotion with her book 'Dead Aid'. In her book she writes that foreign aid is bad for Africa. She believes that aid keeps Africa in a dependent situation and obstructs economic development of the continent. According to Moyo, Africa needs to become self-sufficient. The solution she offers is to terminate all foreign aid within the next ten years. Western governments and celebrities are the ones to blame, claims Moyo. Western governments maintain this vicious cycle of aid by investing money in corrupt regimes. Celebrities, such as the famous rock star Bono, have a negative impact on the PR of Africa. They make negative subjects, like war and starvation, visible to the world without considering the negative impact this could have on African individuals. When foreign aid is stopped and, as a result corruptive governments have disappeared, Africans will see more opportunities and will start developing their own economy, is Moyo's belief. Trade and foreign investment are the keywords which can lead to sustainable development (Bandow, 2009).

Another example of an individual who thinks that development of the private sector is the answer to eradicate poverty is the well-known economist Jeffrey Sachs. Jeffrey Sachs has an impressive curriculum vitae. He is, among others, 'the Director of The Earth Institute, Quetelet Professor of Sustainable Development, and Professor of Health Policy and Management at Columbia University' ('Prof. Jeffrey Sachs, director', para. 1.) In 2005 he wrote his book 'The end of Poverty'. He wants to convince the world that it can eliminate extreme poverty from the planet by the year 2025. Sachs uses a similar definition of 'extreme poverty' of the World Bank: any person who must live from less than one dollar a day. He describes the term as 'the poverty that kills'. In Time magazine, from March 2005, he states that 'we need to adopt a new method', (...) 'clinical economics', to underscore the similarities between good development economics and good clinical medicine' (Sachs, 2005, para.10). The 'medicine' that has been given for the last decades does not cure the situation of the extreme poor in developing countries. Solving this extreme poverty problem requires global cooperation. Sachs explains that a few centuries ago, people in the western world were poor as well. As a result of the Industrial Revolution the western world generated economic growth, population and income growth. This enhancement of the living standard of the western world created a certain superior feeling, which again resulted in 'brutal forms of exploitation of the poor during colonial rule, and they persist even today among those

who lack an understanding of what happened and is still happening in the Third World' (Sachs, 2005, para. 16). Several political, historical and geographical factors have caused that developing countries did not develop as fast as the western world. These factors are not equally divided among developing countries and every single situation of a country needs to be 'diagnosed as a doctor would a patient' (Sachs, 2005, para. 38). Critics argue that too much aid is given to Third World countries, such as Africa. However, Sachs believes that the amount of money given to Sub-Saharan Africans is undoubtedly insignificant: \$30. According to Sachs there are nine steps to end poverty: 1. 'Commit to the task'; 2. 'Adopt a plan of action'; 3. 'Raise the voice of the poor'; 4. 'Redeem the U.S. role in the world'; 5. 'Rescue the IMF and World Bank'; 6. 'Strengthen the U.N.'; 7. 'Harness global science'; 8. 'Promote sustainable development'; 9. 'Make a personal commitment' (Sachs, para. 40-52).

The Bottom of the Pyramid theory, supported by the well-known professor C.K. Prahalad, stimulates to invest in enterprises on the bottom of the economic pyramid. This theory is another way to look at private sector development. Four billion people in the world earn less than \$ 2000 a year. This group is 65% of the world's population. However, large companies are anxious to invest in this large group, because of several difficulties such as corruption, illiteracy and doubt of people wanting to buy other products than products which can provide for basic needs. Prahalad and Allen Hammond think these views are outdated and need to be changed, according to their publication 'Serving the world's poor, profitably'. The bottom of the pyramid has great economic potential and has already been found by several companies. Foreign direct investment, for instance, creates jobs. Prahalad explains that there is a growing interest in small and medium-size enterprises because they contribute to employment in poorer countries. Here the importance of SMEs is highlighted. Often people think that poor individuals do not want to buy luxury items. Nevertheless, many people in developing countries are in the possession of a mobile phone or a television set. According to Prahalad and Hammond the explanation of people buying luxury items is that other options, like buying a house, are not realistic for inhabitants of developing countries. Moreover, they rather spend their money on products and services which are available at the moment and can advance their lives. The persons who form the bottom of the pyramid even tend to pay much higher prices than the persons above this segment. It seems that new innovative technologies, like mobile phones and the internet, can be easily implemented in developing countries and inhabitants do not seem to have difficulties using these technologies (Prahalad, 2002). Prahalad is someone who thinks 'out of the box' concerning international cooperation. Prahalad tends to see things through private sector development.

Another advocate of private sector development is the Peruvian Hernando de Soto. De Soto believes that the major issue 'that keeps the rest of the world from benefitting from capitalism is its

inability to produce capital' (2000, p.5). According to De Soto, the majority of the poor in developing countries already own the property which can create capitalism. Yet, these assets are not formally recognized by governments as, for example, collateral for obtaining loans. As De Soto describes it poetically: 'They have houses but not titles; crops but not deeds; businesses but not statutes of incorporation' (2000, p.7). This is the explanation for the fact that individuals in developing countries cannot create their own form of capitalism. These people are not able to create their own capital and therefore De Soto calls this phenomenon 'the mystery of capital'. To him, this is the most important mystery. Besides the mystery of capital, De Soto also sees four other mysteries: the mystery of the missing information, political awareness, missing lessons of U.S. history and legal failure (De Soto, 2000, p. 11-12). The mystery of the missing information means the missing information of the assets of the poor. Organisations and governments have not documented these assets. Furthermore, individuals who want to open their own business have to wait months to register their business, pay high registration fees and authorization to build a house on state-owned land could even take years. The system of these countries does not at all cooperate with its residents and immigrants. If one cannot keep up with the system, one has to find another way to survive (De Soto, 2000, p. 18-21). This can be done by creating one's own business outside the formal sector. De Soto calls this phenomenon 'extralegal' (2000, p. 21). Entire industries have originated from the extralegal sector. Here, people are working without a license and provide for transportation. The assets of the poor are dead capital (De Soto, 2000, p. 28-30). However, this does not mean that it has no value. According to De Soto 'the total value of the real estate held but not legally owned by the poor of the Third World and former communist nations is at least \$9.3 trillion' (2000, p. 35). There are no issues within the informal sector, but there are constraints from the side of the government. Governments should modify their systems of legal property in order to let the informal sector become formal. The extralegal sector is doing business and building houses outside the law, while not doing anything wrong. This is the mystery of political awareness (De Soto, 2000, p. 69-103). With the mystery of the missing lessons of the U.S., De Soto wanted to find out how individuals in western societies obtained the right to property rights. He studied the history of this observable fact in Western countries and came to the conclusion that the property of people in developing countries is not assimilated in the formal legal system. As a result they cannot use this to create capital (2000, p. 106, 149). De Soto learned from the U.S. that developing countries 'must find the real social contracts on property, integrate them into the official law, and craft a political strategy that makes reform possible' (2000, p. 151). The mystery of legal failure explains that reforms do not change the system of property rights, because the rules already exist in the extralegal sector. A legal and political structure should be built to combine the social contracts from the informal sector with a formal property system in a way that it does not really differentiate

from the extralegal customs. Eventually, a formal social contract will come to existence (De Soto, 2000, p. 170-172). With these five mysteries, De Soto hopes to overcome the vicious cycle of poverty.

Despite the crisis several individuals are claiming that foreign investment or business in development are the answers to generate sustainable economic and social growth in developing countries. Private Sector Development is measured by several research organisations, governments and development organisations. Every country measures its economic development. Yet, there are quite a few points of view on how to measure this development. Performance researches compare a number of countries on their economic performance. The results of these researches can be very useful for countries to decide on where they are standing economically and consequently they can set targets to enhance their situation. Research organisations who measure economic development are: the World Economic Forum, the Commonwealth Business Council, Fraser Institute, the Heritage Foundation, IMD Lausanne, the World Bank, the European Bank for Reconstruction and Development, PRS Group, and the Kauffman Foundation (Hood, 2007). The Global Competitive Report of the World Economic Forum, for example, evaluates the economic competitiveness of countries and ranks the situation of countries. The report covers 102 countries of which nine developing countries outside Sub-Saharan Africa and has two indexes: the Global Competitive Index and the Business index (Hood, 2007, p. 11, 12). The Netherlands, for example, belongs to the top 10 of the ranking list of 2008 (WEF, 'Global Competitive Report', 2008, list section). The World Economic Forum measures three pillars which they consider as most important for economic growth: 'technology, macroeconomic environment and public institutions' (Hood, 2007, p. 12). Their information is collected from statistics and surveys. The World Economic Forum has also done competitive researches on Africa, since the 1990s. In the Africa Competitiveness Report 2009 the prospects for sustainable growth are highlighted and the issues the region encounters to sustainable competitiveness and economic development are discussed (WEF, 2009, p.3). Aid agencies also see the importance of Private Sector Development in developing countries and try to assist these countries in the process. These agencies calculate the results from their programs and tasks which aim to develop the business situation of developing countries. Aid agencies who measure private sector development are, according to Hood, (2007) 'the World Bank, International Finance Corporation, European Bank for Reconstruction and Development, Department for International Development of UK, Inter-American Development Bank, and Asian Development Bank' (p.35). Not all of these agencies seek to help Third World Countries, such as the European Bank for Reconstruction and Development which aims to promote entrepreneurship in Central and Eastern Europe and the former Soviet Union.

The World Bank has a few survey instruments which their country offices use to form decisions and objectives. These surveys are PICS, RICS and Doing Business. The survey of which the principal aim is to set targets is called CAS. Zambia and Cameroon are two examples of countries where the World Bank is introducing the CAS survey (Hood, 2007. p.35-37). The 'Doing Business' survey especially 'looks at domestic small and medium-size companies and measures the regulations applying to them through their life cycle' ('About Doing Business', p. V). The reason why they especially look at small and medium-size enterprises is that these 'are key drivers of competition, growth and job creation, particularly in developing countries' ('Doing Business', p. VI). Most economic activity can be found in the informal sector of developing countries. Market-enabling policies can prevent SMEs to enter the formal economy. SMEs are in particular 'vulnerable for crowding out' when it comes to obtaining credits, according to the World Economic Forum (2009, p. XIII). And this is not the only issue entrepreneurs of SMEs have to face. It is clear, as in the earlier mentioned examples, that local development of small and medium-size enterprises forms a crucial part of private sector development in developing countries and the realisation of pro-poor economic growth.

Hence, in order to create prosperity by economic growth, private sector development is needed. After the failing of the state-owned enterprises in the former colonial states, privatization became increasingly important. Two approaches are seen as important backgrounds of the thinking around private sector development: the neoclassical and the neo-structural approach. The latter approach follows the idea, in contrast to the neoclassical approach, that governments have to interfere when they see that the situation of the market is worsening. There are various theories about how to develop the private sector. The most recent theories concerning this subject are invented by: the United Nations with their Millennium Development Goals, Dambisa Moyo who argues that aid must be stopped, Jeffrey Sachs who wants to end poverty by 2025 due to individual treatment of states, Prahalad by investing in the bottom of the theory; and Hernando de Soto by giving the poor their property rights. Research to the situation of the private sector in developing countries and developed countries is done by various organisations, such as the World Bank, the International Monetary Fund and the World Economic Forum.

### 3 SME Development

#### 3.1 SME Development and its importance

There is a growing interest in development of small and medium-size companies. In the first chapter the importance of private sector development has already been highlighted. Yet, SMEs are just a small part of the private sector and have not always been as important as they are nowadays. During the 1960s and 1970s governments believed that state-owned and large enterprises were the answer to poverty. A few decades later, in the 1990s, the number of small and medium-size enterprises in developing countries began to grow, as a result of growing interest from investors in the 1980s. This growing interest was a consequence of the worsening global economic situation, such as the oil shocks in the 1970s. The labour market which mainly consisted of large enterprises shrunk. The alternative was to start smaller businesses. These were 'more accessible to the poor, the less skilled and the less sophisticated', according to Mukras (2003, p.62). Mukras describes three reasons for the attraction of small and medium size enterprises in developing countries. Firstly, SMEs mostly survive competitiveness in times of poor economic situations. Secondly, the labour capacity of SMEs is very high and modal expenses per job are lower. The third reason is that SMEs seem to have other advantages, such as the small amount of money one needs to start an enterprise and the fact that they can generate development of entrepreneurs and technologies (Mukras, 2003, p. 62).

There are, however, several divergent opinions about the development of small and medium-size enterprises. First, how can we define a small and medium-size enterprise? There are several opinions about the limit of employees an SME has. According to 'Ayyagari et al (2005) (...) a large number of sources define an SME to have 0-250 employees' (As cited in: ODI, 2008, p.3). 200 employees is the average for SMEs in Africa. Now this is clear, another question remains important: why do these types of companies play such an important role in the growth of a developing country's economy? According to Ross Levine there are three main arguments to support small and medium-size enterprise development in particular, instead of micro-enterprise or large enterprise development. The first argument is that 'competition and entrepreneurship', 'efficiency and innovation' (2006, p.67) is generated by these enterprises, which of course boosts up the economy. Some SME supporters argue that these companies are more labour intensive than large firms plus the productivity of SMEs is more advanced (Brainard, 2006, p. 67). The underdeveloped situation of small and medium-size enterprises can be improved, according to the 'pro-SME view', by 'direct government support' (Brainard, 2006, p. 68). Besides, if entrepreneurs face issues in the field of 'financial and legal institutions', they merely need to be resolved



(Brainard, 2006, p. 68). The World Bank, as well as other international organisations, is an advocate of SME development. This type of venture is the main component in the strategy of the World Bank, because it can foster economic development, poverty decrease and occupation. Yet, it is not an odd thought of the western world to believe that small and medium-size firms are the answer to economic growth. Most employment in the United States, for instance, is generated by small businesses (Brainard, 2006, p. 9). Wilfried Luetkenhorst, 'former director of UNIDO', explains that 'in economic and industrial development, a critically important role is played by micro, small and medium enterprises which, on average, make up over 90% of enterprises and account for 50 to 60% of employment- in particular in the developing world' (As cited in: Nelson, 2007, p.46). According to Jane Nelson, in 'Building linkages for competitive and responsible entrepreneurship', small businesses create several economic and social impacts. The term 'small businesses' refers to all micro, small and medium-size enterprises. Other economic impacts these firms generate are: 'equality of income distribution', 'innovation' and the 'economic transition' of agricultural economies to 'industrial economies' (Nelson, 2007, p. 48). Besides the impacts small businesses have on the economy, these can also uplift the situation of social welfare, such as the increase of 'household income' which also improves the situation of women in a society, the creation of jobs for the youth, 'providing for goods and services for low-income communities' and small enterprises provide for education for the poor. The increase of small enterprises also inadequately affects the environment. On the other hand, the number of 'eco-friendly enterprises' is rising, such as companies in the tourism sector (Nelson, 2007, p. 48).

Nevertheless, if there is a 'pro-SME view' there must be a sceptic one. According to Ross Levine, sceptics see more benefits for large companies, because these kinds of enterprises can effortlessly pay for high costs concerning research and development and they have the possibility to develop larger economies. The second argument against advocating SME development is that several studies clarify 'that SMEs are neither more labour intensive nor better at' creating employment 'than large firms' (Brainard, 2006, p. 68). There even are critics who argue that if there is a large share of small and medium-size businesses in a country, the financial system is working incorrectly which enables these enterprises to grow to the extent of a large firm. Moreover, sceptics do not believe that subsidising SMEs is the answer to overcoming their issues. Institutions that provide for policies in the business area need to improve their skills so that SMEs can create economic growth. Furthermore, the focus of private sector development should not only be on improving the position of SMEs, but on all kinds of enterprises, according to the critics of SME development (Brainard, 2006, p. 68). According to the Overseas Developing Institute a research which compared 45 developed and developing countries has shown that SMEs can cause serious GDP growth. Yet, this does not mean that an SME is the only form of enterprise that can

create economic growth, 'alleviate poverty or decreases income inequality' (ODI, 2008, p.4). Still, why should the size of the enterprise be such an important factor of economic development? Patricof and Sunderland argue that 'growth matters more than size', nevertheless, the 'SME sector (...) remains both the life-blood of the economy and the most challenging for policymakers to understand and financiers (...) to serve' (Brainard, 2006, p.75-76). Or, as Brainard argues: 'size definitely matters when it comes to evaluating enterprise needs and constraints' (2006, p.9). To be exact, micro- small and medium enterprises have serious issues which hinder economic development (Brainard, 2006, p.9).

To conclude, small and medium enterprise development in Sub-Saharan Africa arose during the 1980s due to the poor economic situation worldwide which caused an increase in the number of SMEs in Africa. There are differing opinions regarding small and medium size enterprise development. There is the so-called pro-SME view and a sceptical SME view. Clearly, the advocates of the pro-SME view believe that SME development is needed, because Sub-Saharan Africa's economy needs a developed SME sector to create, for example, employment. The sceptical SME view approaches private sector development from the side of the large enterprises, which do not understand the necessity of the use of smaller enterprises to create economic growth.

### 3.2 The main issues of entrepreneurs in SSA

It is clear that private sector development is important for economic growth. However, PSD could only be effective if constraints for SMEs in developing countries are known. Warrick Smith sees four major issues which he translates to 'four underlying challenges': 'rent seeking and corruption', lack of policy reliability, missing social consensus and insufficient policies (Brainard, 2006, p.35-36). Besides these constraints there are other issues which can be added to the four above mentioned. In general, small and medium enterprises in Sub-Saharan Africa meet several limitations. They particularly face problems with 'access to and costs of finance, access to electricity, corrupt practices, tax administration, low skills levels and poor transportation/infrastructure', according to the Japan International Cooperation Agency (2008) in its report 'Donor support for private sector development in Sub-Saharan Africa' (p. 5).

A lot of issues African entrepreneurs face are caused by government. In most African countries this is a major constraint which causes several other direct issues for SMEs. According to the World Bank 'corruption, tax rates and administration, and crime' (2007, p.12) are important issues, especially for entrepreneurs who obtain a middle income. Kurokawa, Tembo and Te Velde explain that 'legal constraints are more binding on growth performance for smaller firms than for larger

firms' (ODI, 2008, p.7). Often governments do not sufficiently support enterprises to grow by, for example, implementing purposeful policies. Clearly, measures that are taken by government usually do not support the target group. The time an African entrepreneur spends on governmental regulations is 5%. Especially in oil-rich areas managers have to spend more time on regulations (WEF, 2009, p.91). Because of corruption money flows down to inadvertent persons. Politicians discriminate between enterprises and try to benefit from the regulations. They have the power to penalize and remunerate certain enterprises (Brainard, 2006, p.35). An example of the constraining capacity of governmental officers is the fact that tariffs in Ethiopia were disadvantageous for local producers. This example could make one wonder if African entrepreneurs could ever break through this cycle.

A policy issue South-African entrepreneurs have to deal with is the Agricultural land Act of 1970 in South-Africa. This law prevents individuals to divide their agricultural land without the consent of the Minister. As a result, farmers cannot use new innovative technologies which can cause a rise in the crop of small parts of land. Also permission from the Minister is needed if a farmer wants to rent out part of his land to lodgers for more than a decade. Obtaining land, therefore, is very complex. In Sub-Saharan Africa administrative procedures can take a very long time. The systems can also be very complex. In Senegal, for instance, entrepreneurs had problems with administrative matters (Beyene, 2002, p.137). Last year, however, the government of Senegal has implemented all kinds of reforms to improve the economic environment (World Bank, 2009, p.2).

Taxation also forms an immense problem. Establishment and growth of SMEs is often not supported by tax advantages for enterprises. The tax system is very intricate and entrepreneurs have to pay the costs of their tax responsibilities. Yet, these costs are equal to a supplementary tax. African enterprises are 'among the most highly taxed firms in the world' (2009, p.87), according to the World Economic Forum. Corporate tax rates in Africa are about 30%. While the lowest corporate income tax, 5%, can be found in Botswana, the highest rate in Africa is 40% and can be found in the Democratic Republic of Congo. The corporate income tax is not the only high tax in Africa. Property tax and VAT are exorbitant in the continent as well. Ventures in Latin America, the Caribbean and East Asia do not pay more than five percent of their property, while in Africa the rate is around eight percent. The VAT rate in Africa is 16% compared to 11 to 14% in other regions (WEF, 2009, p. 87).

Furthermore, other issues with policies are stated by African entrepreneurs. In her report 'Enhancing the Competitiveness and Productivity of SMEs in Africa' Beyene, from the Council for the Development of Social Science Research in Africa, writes that 'the basic conditions of employment creates problems' for SMEs (2002, p. 137). A basic condition is to increase the

percentage of the minimum overtime-rate from 133% to 150%. SMEs have a problem with the high costs of this condition. Entrepreneurs also believe that 'leave provision', 'the organisation of working hours' (p.137) and the reduction of working hours per week (from 46 to 45 hours) cost them too much (Beyene, 2002). Of course, a lot of reforms have been implemented in African countries over the years with the aim to eradicate the various issues of small and medium-size enterprises. The number of reforms is still growing (World Bank, 2009, p.2). Yet, entrepreneurs need to consider these reforms as realistic. Previously, governments have implemented laws and regulations which have failed. Therefore, credibility of reforms is an important factor. This also counts for public support. People need to have faith in their government so that reforms can be successfully put into practice. Governments, consequently, need to be transparent about their laws. That way, inhabitants will be less concerned about the risk of corruption, for example (Brainard, 2006, p.36).

Another major issue is the access to finance. Above all, SMEs encounter the problem of the so-called 'missing middle'. Micro-enterprises and large enterprises can flourish due to the microloans and commercial loans. Small and medium-size enterprises, however, find themselves in the middle of these types of enterprises and do not have sufficient access to financial services. According to Patricof and Sunderland 'Donors need to face the reality that the young companies that can really move the needle on innovation, inspiration, and employment need high-risk, reasonably-sized equity investments to grow, not the limited doles of short term, high interest debt currently provided' (As cited in Nelson, 2007, p. 85). There is a gap between micro- and large enterprises which creates a blockage for small and medium-sized enterprises to grow. Van Biesebroeck argues: '(...) transitions between size classes or movements in the productivity distribution are very slow, especially at the top of the size or productivity distribution. Large firms remain large, and more productive firms remain at the top of the distribution. Smaller and less productive firms have a very hard time advancing in the size of productivity distribution' (As cited in: UNIDO, 2008, p. 17).

Most SMEs are active in the informal sector. Entering in the formal sector creates problems for these enterprises. In order to obtain a loan, a firm needs to hand over certain documents which SMEs from the informal sector generally do not possess, such as financial reports and legal papers. In SSA, there are not many special funds available with start-up capital for companies. As a result, the sector is not likely to grow. Tadesse, Executive Vice-president of the Development Bank of Southern Africa adds three more constraints for SMEs which form severe finance gaps. The first is that SMEs cannot offer banks the required collateral (Tadesse, issue may 2009, p.17). In Africa, the requirement to obtain a loan is 'to post collateral for 137 percent of the loan', as per the Africa Competitiveness Report (The World Bank, 2009, p.89). The lack of skills and knowledge of using

the offered capital in a lucrative way is a second problem for African SMEs, Tadesse noticed (Issue may 2009, p.17). The U.N. Commission stipulates that skills and knowledge are essential for entrepreneurship: 'A firm's competitive advantage comes from its entrepreneurial capabilities; its management and technical know-how, including labour-management relations, information technology skills, basic finance, economics and project management; as well as the skills, education and adaptability of its employees' (As cited in: Nelson, 2007, p. 85). Nelson argues that it is not only a lack of skills, but that there is also a lack of will of entrepreneurs on this area. Thirdly, Tadesse describes the issue of discrimination of firm age, location and gender. It is hard for newly founded SMEs to receive finance. This is in contrast to the enterprises which have been existing for years. In addition, access to finance is very limited if a company is situated in a rural area. Discrimination of gender forms a major problem for female entrepreneurs, explains Tadesse (Issue may 2009, p.17). Gender discrimination is a very severe problem and will be further explained in the next sub-chapter.

The access to energy is very limited. The urban population profits from energy provision, while the rural population still utilises biomass for cooking and heating. The 'middle/upper income groups and (...) the formal commercial and industrial subsector' are the fortunate groups who have supply of power. The financing of the power sector is conventionally done by government in Sub-Saharan Africa. Because of this subsidisation by governments tariffs are low which often does not lead to sustainable development. However, in many of the French-speaking countries of Western SSA tariffs of energy use are sky-high. As a result, the impact for electricity consumers with a low-income can be very disadvantageous (Amenya, et al., 2004, p. 25). In Africa, the average costs for one kilowatt hour of electricity are 0.068 US dollars. This is a high amount compared to other regions in the world. The only place where electricity costs are higher is in South Asia. In oil-rich countries costs are, obviously, lower (20%). On the other hand, individuals in landlocked countries need to pay fifteen percent more (World Bank, 2009, p. 85). Countries in Sub-Saharan Africa that belong to the lowest income countries have severe problems with access to electricity, according to almost 70% of these countries (World Bank, 2007, p. 11). Besides, inhabitants of the Sub-Saharan African region have to deal with outages of electricity. These outages can last up to 12 hours. Consequently, enterprises need to purchase generators to fill the gaps of outages. Thirty-eight percent of the ventures in Africa own a generator. However, these generators are expensive and can cost up to a million US dollars. As a result, businesses which cannot afford a generator lose sales and businesses which can afford one are saddled with the purchasing costs of a generator (World Bank, 2009, p. 91).

Electricity links to infrastructure. Clearly, electricity costs are regarded as a main issue by entrepreneurs. Nevertheless, there are more infrastructural problems in Africa. It is very odd that

not so many issues of entrepreneurs in the infrastructural area are known. During the 1980s and the 1990s private sector development became very important. Governments and international organisations hoped that the condition of Africa's infrastructure would ameliorate. As a result, they left infrastructure totally out of account in policymaking. Yet, electricity, transport, sanitation, water and telecoms are extremely important subjects. As the Commission for Africa puts it in its report of 2005 : 'Infrastructure is a key component of the investment climate, reducing the costs of doing business and enabling people to access markets; is crucial to advances in agriculture; is a key enabler of trade and integration, important for offsetting the impact of geographical dislocation and sovereign fragmentation, and critical for enabling Africa to break into world markets; and is fundamental to human development, (...). Infrastructure investments also represent an enormous untapped potential for the creation of productive employment' ('Going for growth and poverty reduction', 2005, p. 233). The infrastructure in Africa is underdeveloped. It seems that foreign investors are more likely to invest if the infrastructure is more developed. Therefore, a more developed infrastructure could generate economic growth. This also counts for electricity, telecommunications and transport. Hence, these are constraints for African entrepreneurs, albeit indirectly (IMF, 2006, p. 10-11). Sub-Saharan Africa is a immense region with a poor infrastructure: a small number of roads and long distances that have to be covered. Because of the many landlocked countries in SSA the inland transportation costs are incredibly elevated. Moreover, import and export handling fees are higher than in other developing regions of the world. The transport system is not efficient. Consequently, production costs can be a lot higher than they should be. Many enterprises have to buy their inventories in advance, because 'the delivery time of inputs is uncertain', according to the World Economic Forum (2009, p.91).

Entrepreneurs of SMEs in the region have to deal with several constraints to their businesses. These are governmental and financial issues, lack of electricity and infrastructure. Both men and women face these constraints.

### 3.3 Main issues of Sub-Saharan African women entrepreneurs

Women meet the same obstacles in running a business as their male counterparts. Nevertheless, are there any differences in obstacles for women and men entrepreneurship? In the Africa Competitiveness Report of 2007, the World Bank explains that there are differences in perceptions of constraints between the two sexes. This differs, however, per country. In some countries corruption is seen as a major constraint by women while men do not see corruption as

such an important issue for their enterprise. In most countries both men and women indicate the same problems as important issues.

Women who already own a business do not seem to have more issues than men. However, inequality is still a very severe issue in Sub-Saharan Africa. As Nelson Mandela said in 2005: “Massive poverty and obscene inequality, are such terrible scourges of our times — times in which the world boasts breathtaking advances in science, technology, industry and wealth accumulation — that they have to rank alongside slavery and apartheid as social evils” (Watkins, 2005, p. 4). A lot of constraints women face, occur during the start-up of an enterprise (World Bank, 2007, p. 73-76). In a lot of countries in Sub-Saharan Africa women are not equally treated under the law. According to a paper prepared for the United Nations Conference on trade and development (1999, p. 321) they face problems with obtaining contracts, asset holding, prejudiced labour policies, property rights and inheritance laws. Property rights and inheritance laws can give a woman the freedom to take care of herself and her family. Douglas argues: ‘(...) in denying women the equal right to inherit and hold property on a par with men has serious consequences for women’s physical and economic security and can also be detrimental to national development’ (2007, p. 12).

Besides these constraints women have to deal with lack of access to education and healthcare, and cultural acceptance. Many women in the region are illiterate and one of the main causes is the fact that costs of attending school for young girls are too high (UNCTAD, 1999, p. 320). Illiteracy of women, for example in Senegal, is 78% (De Groot, 2001, p. 13). Girls are expected to do chores in the household and because of bad infrastructure their help is needed. Besides, people do not often see the advantages of education for girls (UNCTAD, 1999, p. 320). Women do not have much spare time left besides the time it takes to do their daily chores, which prevents them from entering the private sector. Especially women who live in rural areas have to travel long distances to reach adequate educational and informative organisations (De Groot, 2001, p. 9). Unfortunately, women are not always well-informed about the possibilities of education and the availability of help to establish a venture (De Groot, 2001, p. 15).

Moreover, cultural aspects are very important in the division of labour between the two sexes. Women are expected to have jobs that are directly linked to housekeeping, for instance cultivation and manufacturing textiles (UNCTAD, 1999, p. 320). In Senegal, for example, women are forced to have an extra job. On the other hand, in some cultures women are not allowed to work on the land due to a certain belief that women will ruin the crops, such as in Ethiopia. For women who are discriminated by cultural values it is extremely difficult to throw the great cast and start to act independently. Clearly, in many cultures women are not treated and seen as equal by men. Polygamy, for instance, is a tradition that keeps women in a totally different position than men.

Although legal constraints for women may be limited, socio-cultural aspects may be vital for women's decisions (De Groot, 2001, p. 7-8).

When women want to gain start-up capital for their enterprise, options for obtaining loans and credits are very limited. What women traditionally do, is obtaining loans from their direct social environment: family, friends, tontines (credit lending groups) and the local financier. As a result, women need to start their venture in the informal sector (UNCTAD, 1999, p. 320-322). Besides, women are often too shy to approach a legal financier and usually do not have a big network where they can get information and help from, outside the informal sector (De Groot, 2001, p. 10).

Besides the constraints women face when they want to start an enterprise, constraints are also faced by women who want to expand their micro-enterprise to a small and medium-size. The UN recognizes several constraints such as limited projects to encourage women to start an SME and limited results of policies which have the goal of promoting women in the private sector. Secondly, there is lack of competition due to the fact that most enterprises sell the same products and cover only a few sectors. These sectors, such as the food sector, UNIDO explains, are 'an extension of' the 'traditional roles' of women (2001, p.9). A disadvantageous legal environment and lack of projects which stimulate growth are other constraints female entrepreneurs in Africa have to deal with (UNCTAD, 1999, p. 322). Several institutions in Zimbabwe, however, provide for training to SME entrepreneurs. Yet, not every institution involves women in their project (De Groot, 2001, p. 13).

Thus, women entrepreneurs defy other constraints than men when starting a business in the SME sector: inequality issues, lack of access to education and healthcare, lack of cultural acceptance, financial issues and constraints to expand a micro-enterprise into a small and medium-size enterprise.



#### 4. Conclusion

To be able to answer and to understand the question why the countries in Sub-Saharan Africa do not succeed in developing their SME sector one first has to look at the explanation of private sector development.

Private sector development is a very clear term which is also used globally. In developing countries the private sector originated during the 1980s. Before this period, economic growth was also very important. Yet, its aim was not to develop the private sector, but the public sector. Because the system of state-owned enterprises failed, privatization became the emphasis. Ideas about PSD have changed over time. Nowadays, organisations in the developing sector believe that generating economic growth through private sector development must create not only prosperity for developing countries, but wellbeing as well. A lot has been written and a lot of projects have been set up with regard to private sector development. All with the same goal: generating economic growth which must lead to the end of poverty. Several individuals have done serious research to realize this aim and developed their own theory: the UN, together with 189 countries, has drawn up the Millennium Development Goals, development aid must be stopped, according to Dambisa Moyo, Jeffrey Sachs argues that poverty can be ended by treating each developing country individually, in the opinion of Prahalad people should invest in the bottom of the pyramid, and De Soto wants developing countries to give the residents their property rights. These are recent theories which rather differ from each other. Yet, there is not one unburdened solution to ending poverty. For years, the world has tried to solve this severe problem. Projects have come, projects have failed. The global community could not raise Africa's economy to western standards. Nevertheless, we have seen economic growth of Sub-Saharan Africa before the global economic crisis. This crisis is precisely the phenomenon that causes another issue for this region. Sub-Saharan Africa is subject to this global crisis if it has the same economic system as the west.

One part of the private sector especially does not seem to flourish: the SME sector. Therefore, one must be able to answer the question: 'What is SME development and what are the main issues of entrepreneurs of SMEs in Sub-Saharan Africa?' As a result of the poor global economic situation the SME sector in Africa began to grow. The development of these Small and Medium-size Enterprises became increasingly essential for governments and international organizations. Many of these international organisations nowadays believe that the SME sector generates employment, economic growth, innovation, competition and diverse other economic and social impacts. Yet, others do not necessarily see the advantages of development of this sector. Proponents of this sceptical SME view argue that large enterprises contribute much more to economic development. They see no difference between small and medium-size enterprises and

large enterprises concerning the creation of employment. Furthermore, they rather want good working large enterprises than SMEs that cannot grow due to an inefficient financial system. In western countries there is a large share of SMEs and for this reason, and the above-mentioned other reasons, many individuals of the developed world believe there must be a large SME sector in developing regions too. There are as many arguments for SME development as against. No one exactly knows whether a large SME sector will eventually lead to a good and stable economic situation or not. What we know is that it did work for the developed world. Despite all the hard work, entrepreneurs still face severe issues with government, finance, energy and infrastructure. Moreover, women entrepreneurs seem to face several constraints when starting an SME, which obviously does not contribute to the development of this sector. They defy inequality issues, lack of education, healthcare and cultural acceptance, finance constraints and issues with expanding their micro-enterprise.

To conclude, there is no clear answer to the question why countries in Sub-Saharan Africa do not succeed in developing their SME sector, besides the clear issues entrepreneurs of these enterprises defy. Many have tried and are still trying to develop a solution for Sub-Saharan Africa's economy in a way that the region can eventually compete internationally. Nobody knows what the outcomes of these theories are, unless one tries them out. However, is the global community willing to, for example, cut all aid off, as Dambisa Moyo proposes? Besides, the question rises if Africa wants to generate economic growth by a western system which also makes them subject to the economic crisis. What we do know is that, if the global community wants to develop Sub-Saharan Africa's SME sector, one needs to find a solution for the several governmental and financial issues and the lack of electricity and infrastructure.

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