Briefing Notes for AfDB’s Long-Term Strategy

Briefing Note 3: PRIVATE SECTOR DEVELOPMENT STRATEGY

Date: 7 March 2012
PRIVATE SECTOR DEVELOPMENT STRATEGY

I INTRODUCTION

1.1 No government can rely exclusively and indefinitely on redistributive development models when the majority of its population remains economically marginal. Broad based and accelerated growth is critical for job creation and a sound fiscal system could produce revenue flows that would enable governments to channel resources into socio-economic infrastructure and basic social services for those that are most vulnerable. Such growth, which must be inclusive to forge social cohesion, requires widespread access to economic opportunities. A dynamic private sector is critical to achieving the inclusive growth that creates these economic opportunities. Development strategies and investment plans must leverage the potential of private capital as an agent and partner in growth and development.

II THE ECONOMIC CONTENT

2.1 Between 2000 and 2010, Africa’s cumulative growth rate averaged between 5% and 6%, thanks to greater political stability, strong global economic performance and domestic macro-economic reforms. Economic policy reforms are progressively redefining the State’s role in the economy as an enabler of private sector-led growth. Much of the emphasis, to date, has been on attracting foreign direct investment (FDI) through deregulation and incentives. Over the past decade private FDI overtook overseas development assistance as the primary source of FDI-led growth. As a result, the continent’s economies are better integrated into the rest of the world.

2.2 Economic integration offers opportunities and risks. Buoyant global economic conditions increase demand for African exports, particularly commodities, as well as external private investment and financing inflows. In turn, FDI also enhances technology transfer, grows total capital stock and improves total factor productivity. A contracting global economy, by contrast, rarifies trade outflows and investment inflows and makes financing more scarce and expensive. African economies are suffering from the recent triple global economic crises of fuel, food, and finance, which saw a sharp decrease in FDI. The renewed global economy fragility and volatility forecast further FDI contraction, particularly from Africa’s historical trade and investment partners in OECD countries.

2.3 Robust growth has helped reduce the depth of poverty in sub-Saharan Africa, dropping the percentage of those earning less than US$1.25 a day from 67% to 58% between 1998 and 2008. However, the pace of growth has not kept up evenly with population growth. With Africa’s working age population set to increase from about 400 million in 2010, to around half a billion in 2020, there is still much scope for maintaining and accelerating the pace and quality -- breadth, sustainability and robustness -- of growth. Economic growth must create economic opportunities for all, if it is to be inclusive. Sustainable growth must optimize the use of financial, social and environmental capital, by pursuing development models that use resources more productively and efficiently. If Africa’s growth is to become more robust and less vulnerable to exogenous shocks, a more
diverse set of economic partnerships and alternative growth drivers beyond FDI must be
nurtured.

2.4 The Bank’s RMCs must continue to strive to attract much-needed capital and
increase Africa’s current share of less than 5% of global flows. However, FDI alone will not
be sufficient to achieve the quantity and quality of growth needed for the continent to
prosper. African policy makers and entrepreneurs have drawn important lessons from the
2007-2008 global financial and economic crises. Aware of the risks involved in pursuing
undiversified, unshared or unsustainable growth and development models, they are
reaching out to emerging trade and investment partners in Asia and Latin America while
also looking to domestic and regional growth drivers. Increasingly, they recognize the
significance of domestic and regional private sector development alongside FDI for more
robust, inclusive and greener growth.

III THE MISSING MIDDLE

3.1 The African private sector contributes about 80% of the continent’s GDP and
creates about 90% of all jobs in 2012. Micro and small enterprises employing fewer than 20 full-
time employees create between 67% and 80% of jobs and contribute between 30%-35% of
GDP. In the African private sector, there is a “missing middle”, and Medium-sized
enterprises employ between 20% and 30% of the workforce by contrast with the more
dynamic emerging economies and advanced market economies where they make up a
comparatively larger share of all private enterprises and support about two-thirds of all
employment. If African economies are to fully reap the rewards of a government-enabled
and private sector-led growth model, the factors inhibiting the emergence of mid-sized
enterprises must be tackled.

3.2 Supporting the emergence of mid-sized enterprises includes creating the macro-level
conditions for enterprises of all sizes to thrive but also adopting measures that target the
growth constraints and opportunities in each sector. For example, in private services, a
growing middle class and rapid urbanization in Africa create significant potential for growth,
where private investment has expanded dramatically over the past decade, particularly in
trade, transportation and distribution and financial services. Investments in consumer-
oriented sectors generally lead to the creation of many more jobs and stimulate consumer
spending and position African economies to benefit further from private sector expansion.

3.3 Sectors vary as well in terms of their actual and potential contributions to GDP,
private investment, enterprise creation and growth, and employment generation. In the
agriculture and agro-industry sector, overcoming low overall productivity will require
efficiency gains through: increasing the acreage per farmer, improving technology and labor
migration into manufacturing and other higher value-added sectors. In turn, private
manufacturing sector growth is contingent on improved access to technology, infrastructure
and external investment.
IV IMPEDIMENTS TO PRIVATE SECTOR GROWTH

4.1 Unlocking each sector’s potential requires enhancing the competitiveness of the continent’s economy to continue to attract external and pan-African FDI and to nurture the emergence of home-grown “opportunity-driven entrepreneurs” who innovate and take risks to take full advantage of market opportunities. Enabling private enterprises to thrive will depend on addressing the “soft”, “hard” and “enterprise-level” disablers.

4.2 Two-thirds of African entrepreneurs rate at least one of the following four soft disablers – corruption, customs and trade regulations, tax administration and rates, labor regulation. The reform momentum must intensify and focus on establishing appropriate policies to redress these. Accelerating regional economic integration to facilitate the flow of capital, goods, labor, services and technology among countries is also critical to overcoming the small size of most African domestic markets. Achieving systemic labor productivity enhancements remains a priority for enhanced competitiveness.

4.3 Tackling “hard” disablers -- effective, reliable, affordable social and economic infrastructure -- remains a priority. African firms will remain at a competitive disadvantage so long as infrastructure services cost twice as much on average as in other developing regions and tariffs remain exceptionally high by global standards.

4.4 Enterprise-level disablers must be addressed to enable African enterprises to grow and become more competitive. Enterprise regulatory and administrative services place African firms at a competitive disadvantage. Starting a new business is 2.7 times more expensive in Africa than the global average. Women entrepreneurs face even greater constraints, in terms of access to administrative services and finance due to their often unfavorable legal status in many of RMCs. Credit to the private sector has been growing faster than the continent’s GDP over 2005-2009, but remains below levels reported for other developing regions. Without more access to financial services, African businesses will remain behind their counterparts in other developing economies. Small companies struggle the most: despite making up the bulk of African enterprises, only 16% of small firms have access to financial services.

V THE ROLE OF THE AFRICAN DEVELOPMENT BANK

5.1 As Africa’s premier development finance institution, the Bank is best positioned to leverage all the resources at its disposal to support private sector development as a priority to which all operations can and must contribute. Over the last five years, the Bank has in fact registered some important private sector development successes, including a dramatic increase in the volume and number of non-sovereign transactions. Yet, like those of its sister regional MDBs, Bank operations have been predominantly public sector oriented, focusing on non-sovereign operations as the primary vehicle for delivering its private sector development objective. Until now, this has restrained its effectiveness in tackling the disablers of private sector development with equal intensity.

5.2 The private sector is a core institution-wide strategic priority in the Bank’s new long-term strategy. This focus acknowledges that a thriving African private sector is as a vehicle
for inclusive employment creation and income generation. It recognizes that private sector solutions can be effective to scale up investment and enhance the quality of service delivery in infrastructure and skills development. This focus also responds requests made during consultations on the Sixth General Capital Increase and the Twelfth Replenishment of the African Development Fund to both increase the PSD results from operations and for a Bank-wide private-sector policy that acknowledges the critical role of the private sector in supporting RMCs’ efforts to tackle major development challenges.

5.3 The Bank is therefore preparing a private sector development policy making explicit its commitment to supporting this engine of growth and setting future operational directions. The policy’s core objective is to harness African entrepreneurship and catalyze private investment for inclusive growth. It affirms the role of African businesses as agents of African development and of Bank partners in delivering the Bank’s poverty alleviation mandate for prosperity.

5.4 A private sector development strategy is being simultaneously developed to define implementation modalities. It envisions a continent where micro- and small enterprises can grow easily to create jobs, in which financial markets function effectively, where African enterprises can access international capital markets and attract FDI, where businesses generate substantial taxes for governments, and private enterprises partner with governments to deliver social and economic infrastructure for enhanced competitiveness and livelihoods. To realize this vision, the strategy analyzes Africa’s growth and development drivers and specifically emphasizes the characteristics, challenges and opportunities facing private enterprises and their contribution to Africa’s development. It defines a framework for effectively delivering development through the private sector and an action plan for delivering enhanced results.

- **Implementation Framework**

5.5 Implementation will be structured through three distinct, inter-connected pillars defined in relation to the hard, soft and enterprise-level disablers. This framework for effectively delivering inclusive growth and development is designed to enable all African enterprises ranging from MSMEs to large corporations to accelerate i) job creation and regional value added and capital formation and ii) to generate corporate profits, government revenues, and export earnings.

**Pillar I: Business Enabling Environment**

This pillar comprises “soft” enablers such as the role of government, governance capacity and interaction with various private sector actors and civil society. This pillar focuses on developing an enabling environment that allows socially responsible, environmentally-friendly entrepreneurship to flourish within an effective system of public management and civil society. It includes government capacity to develop, maintain and govern market-oriented economic policies under a fair, effective regulatory framework and a favorable business climate. Focal areas include simplifying business processes to promote formalization, strengthening domestic resource mobilization and facilitating trade and regional integration. Pillar I also includes “soft” enablers necessary for Pillar II activities: i.e. supporting government capacity to manage
the planning and implementation of its public investment program in infrastructure notably through PPPs.

**Pillar II: Social and Economic Infrastructure**

This pillar includes “hard” enablers, such as the effective provision of public goods and services that are vital for a thriving private sector that will generate inclusive growth. Key hard enablers include access to reliable and affordable electricity, transportation in the form of ports, airports, roads and railways, water and sanitation, waste management, and broadband and mobile telecommunications services. Pillar II also includes education, health and other social services necessary for a vibrant private sector.

**Pillar III: Productive Enterprises**

This pillar focuses on entrepreneurship development and the deepening and expanding of financial and capital markets. It includes effective financing systems for different types of enterprises (micro, very small, medium and large businesses) in different sectors. It covers methodologies for supporting equitable and sustainable development of natural resources, restructuring and privatization, mergers and acquisitions for enhanced economies of scale and competitiveness. It also takes in business advisory services, and entrepreneurship development for productive enterprises.

5.6 It will be necessary to develop coherence and synergies across these three pillars. Measures to improve the enabling environment should be focused on unlocking and promoting productive sectors with the greatest potential at the country and regional levels. Social and economic infrastructure investments should be explicitly linked to the mobilization of significant new productive investments or the removal of constraints facing existing producers so that they can become more competitive.

- **Delivering Results**

5.7 Effective delivery of development results through the private sector requires systematic attention to the three pillars throughout all Bank operations. Planning specific activities and roles in each region and country will respond to country and region-specific PSD disablers, as articulated through the Bank’s country and regional integration strategies. The Bank’s specific activities and roles in each sector and pillar will be calibrated against internal capacities (capital, instrument, staff, competence and mandate) and will also take advantage of opportunities to leverage other institutions’ capacities and resources through private/commercial, public, non-governmental, or development partnerships.

5.8 The Bank will use a mix of financial and knowledge instruments across all three pillars to effectively deliver development through the private sector. It will systematically seek optimum leveraging of its public resource endowment and resource mobilization activities, tapping public and private resources to complement its financing as necessary. It will also pay particular attention to low-income countries and fragile states, by mobilizing, where appropriate, ADF concessional and non-sovereign financing to amplify the catalytic and development effect of its investment. The Bank will consolidate its economic and sector research, technical assistance and advisory capacity in all three pillars to better
respond to the new strategic imperatives. To effectively deliver these instruments, the Bank will enhance its current skills mix and funding mechanisms substantially.

5.9 The Bank-wide private sector development objective creates an opportunity to achieve meaningful gains on the Bank’s crosscutting priorities: gender mainstreaming, greening growth, better corporate governance standards, supporting fragile states and fostering greater regional integration. In each of the three pillars opportunities exist to further the underlying objective of each of these cross-cutting priorities. For instance, empowering women to participate in the economy entails: tackling regulatory obstacles restricting women’s access to economic opportunities, through policy dialogue instruments, ensuring that education and skills development activities enable women and girls are not excluded from the labor market; and supporting women-owned businesses to access financing.

- **Private Sector Development Action Plan**

5.10 A three-year action plan proposes to focus strategy implementation in five distinct, inter-related, priority areas.

1. Mainstream private sector development in all strategic and resource allocation platforms, from corporate, to country, and sector strategies, policies and business plans;
2. Mobilize additional investment and co-financing systematically in all operations to fully deliver its catalytic potential;
3. Enhance institutional readiness to deliver PSD results by assessing and fine-tuning instruments, resource allocation, business processes, institutional structure and staffing to be Africa’s premier financial institution for private sector development and to deliver across the three pillars;
4. Align quality assurance, performance management and reporting systems with the PSD mandate; and
5. Enhance the visibility of the private sector development approach, experiences and operations at country level for greater accountability and responsiveness to country and regional stakeholders.

**VI CONCLUSION AND RECOMMENDATIONS**

6.1 Given the importance of the private sector for strong, sustained and shared growth, the Bank’s long-term strategy should prominently feature the vision of development through the private sector as a core institution-wide strategic priority. In so doing, it should recall the core thrust of this private sector development strategy and three-year action plan, which propose the following:

- Mainstream private sector development to invigorate African entrepreneurship, in all activities at country, regional and sector levels;
- Fully delivers it catalytic potential by systematically mobilizing additional investment and co-financing in all operations, whether with public or private sector clients; and
• Assess and fine-tune its instruments, institutional structure, resource allocation and management systems, business models and processes and staffing in line with its ambition to be Africa’s premier financial institution for PSD.