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<th>Description</th>
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</thead>
<tbody>
<tr>
<td>AfDB</td>
<td>African Development Bank</td>
</tr>
<tr>
<td>AltX</td>
<td>Alternative Stock Exchange</td>
</tr>
<tr>
<td>DEM</td>
<td>Development Enterprise Market</td>
</tr>
<tr>
<td>IFC</td>
<td>International Finance Corporation</td>
</tr>
<tr>
<td>JSE</td>
<td>Johannesburg Stock Exchange</td>
</tr>
<tr>
<td>MEP</td>
<td>Manufacturing Extension Partnership</td>
</tr>
<tr>
<td>MTTI</td>
<td>Ministry of Tourism, Trade and Industry</td>
</tr>
<tr>
<td>SEM</td>
<td>Stock Exchange of Mauritius</td>
</tr>
<tr>
<td>SMEs</td>
<td>Small and Medium Enterprises</td>
</tr>
<tr>
<td>SMIs</td>
<td>Small and Medium Industries</td>
</tr>
<tr>
<td>SSA</td>
<td>Sub-Saharan Africa</td>
</tr>
<tr>
<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
</tr>
<tr>
<td>UNEP</td>
<td>United Nations Environmental Programme</td>
</tr>
<tr>
<td>UNIDO</td>
<td>United Nations Industrial Development Organization</td>
</tr>
<tr>
<td>URT</td>
<td>United Republic of Tanzania</td>
</tr>
</tbody>
</table>
I. Introduction

Small- and medium-scale industries (SMIs) are important vehicles for creating employment in both developed and developing countries. SMIs are a distinct group of small- and medium enterprises (SMEs) that specializes in high-value industries such as mining and manufacturing, and are critical in the industrialization process. According to the International Finance Corporation (IFC) (2010), the formal SME sector contributes 33 per cent to gross domestic product (GDP) and accounts for about 45 per cent of total employment in developing countries. SMIs in the quarrying and mining, manufacturing, energy, gas and water sectors are of particular importance in the SME sector. SMIs contribute about 45 per cent of manufacturing employment and 29 per cent of manufacturing GDP in developing countries, in contrast to 67 per cent and 49 per cent in developed countries, respectively (IFC, 2010).

The manufacturing sector in South-East Asian countries were dominated by SMIs and played a significant role in the industrialization process, accounting for 78-99 per cent of total manufacturing establishments, 17-71 per cent of industrial output and 39-65 per cent of total exports (Oh, 1994). Other studies showed that about 60 per cent of manufacturing firms were in the group of SMEs (Beck and others, 2010). In Malaysia, 97 per cent of total manufacturing establishments in 2003 were SMIs and accounted for 35 per cent of manufacturing output (United Nations Development Programme (UNDP), 2007).

Very little is documented about the number and contribution of SMIs in Africa and evidence of its relative contribution in employment and national output is not known. Most of the literature focuses on SMEs in general, without paying particular attention to the special characteristics and financing needs of SMIs. In a survey of small firms (Fafchamps and Quinn, 2011), the difficulties they had in identifying small-scale firms in five industries (food processing, garments, leather products, wood products and metal products) were noted.

In Cote d’Ivoire it was estimated that SMIs accounted for 78 per cent of employment in the manufacturing sector (Sleuwaegen and Goedhuys, 2002). McPherson (1996), in a study of SMEs in Africa, found that between 23-75 per cent of enterprises were SMIs in manufacturing and construction sectors. In Malawi, Ebony Consulting International and the National Statistical Office (2000) estimated that SMEs employed over 1.7 million people, representing about 38 per cent of the total Malawian labour force. About 28 per cent of SMEs in Malawi were in the manufacturing sector (Chirwa, 2008). In Kenya, SMEs employed about one-third of all working persons and the sector contributed 13 per cent to GDP in 1995 (Daniels, 1999).

There is consensus that the promotion of SMIs in developing countries, in which the informal sector dominates economic activities, can help towards making progress in the Millennium Development Goal (MDG) of reducing poverty. There is also general agreement in the literature that the potential roles of SME/SMIs in poverty alleviation and in their contribution to economic activities are highly constrained by many challenges that affect these enterprises comparative to the more established large-scale enterprises around the world. Access to sources of finance or capital has been highlighted as one of the major constraints affecting the development of SME/SMIs in Africa. This problem of accessing finance is exacerbated by underdevelopment of financial and capital markets and the general poor macroeconomic policy environment.
The role of finance in the growth of firms has been highlighted in many studies. For instance, Beck and others (2005) provided evidence on the importance of the financial system and legal enforcement on firm growth. There was also evidence on the role of external finance for faster growth in countries with better developed financial systems (Rajan and Zingales, 1998). Dinh and others (2011) found that access to finance was the most binding constraint to growth of firms. Access to finance was also found to be an important factor in explaining the pattern of job creation, and this problem was most acute among small firms (Aterido and others, 2007).

1.1 The role of small- and medium-scale enterprises and industries in development

SME/SMIs play vital roles in economic development and the growth of economies including employment generation, innovations and entrepreneurship development, development of markets and domestic capital formation. First, the major contribution of SME/SMIs is through its potential to generate employment in terms of self-employment and paid employment. For instance, Oh (1994) argues that SME/SMIs, by generating employment, can contribute to poverty alleviation, particularly when located in the rural area as cottage industries. Similarly, Kasekende and Opondo (2003) note that income generation through self-employment have been tools for poverty alleviation.

According to the United Nations Environment Programme (UNEP) (2007), the SME sector is one of the principal driving forces for economic growth and job creation. For many countries in Africa, SME/SMIs and the informal sector represent over 90 per cent of businesses, contribute over 50 per cent of GDP, and account for about 63 per cent of employment in low income countries (United Nations Economic Commission for Africa (UNECA), 2005).

Secondly, SME/SMIs also play an important role in the development of markets by increasing competition. SME/SMIs promote competition, reduce monopolistic tendencies in industries and inefficient allocation of scarce resources (Oh, 1994; Kasekende and Opondo, 2003). In African countries, SME/SMIs have received attention because of their labour-absorptive capacity in terms of both shrinking the public-sector and private-formal economy, and for increasing the number of new entrants in industries thereby promoting competition in various sectors of the economy (Kesper, 2000).

SMIs contribute to the development of the market economy by encouraging competition among enterprises and by reducing inefficiency of a monopolistic or oligopolistic system. SME/SMIs can therefore help countries to exploit the social benefits from greater competition and entrepreneurship because of the external benefits on economy-wide efficiency, innovation and aggregate productivity growth.

Thirdly, SME/SMIs are a training ground for developing business-management skills that provide the economy with a continuous supply of ideas, skills and innovation (Oh, 1994; Kasekende and Opondo, 2003), as well as increasing domestic entrepreneurship. SME/SMIs, through their innovation, have played a major role in the growth and development of all leading economies in Asia.

Fourthly, SME/SMIs play an important role in the formation of domestic capital, especially in import-substitution industrialization or export-oriented industries. The Asian experience clearly shows that it is mainly the growth-oriented medium-sized enterprises among the
SMEs that have a high propensity to apply technology and training and serve specialized niche markets.

Fifthly, SME/SMIs make important contributions to the growth of economies. Ebony Consulting International and the National Statistical Office (2000) estimate that SME/SMIs contribute about 15.6 per cent to the GDP in Malawi. Similarly, in a study of over 70 developed and developing countries, while finding strong association between the importance of SMEs and GDP per capita growth, no significant relation was found between SMEs and measures of the depth and breadth of poverty (Beck and others, 2005). This could potentially be explained by the increasing percentage of households that go into SME activities to enhance household incomes for purposes of sustenance, rather than reinventing in business or savings or as a risk management and diversification avenue (Ebony Consulting International and National Statistical Office, 2000).

Daniels (1999) found that among the SME/SMIs that represent the sole source of income for households in Kenya, 72 per cent made less than the absolute poverty line in urban areas and none of the SMEs in rural areas made returns above the absolute poverty line. This has raised questions about SME/SMI sufficiency to support a household.

1.2 Objectives of the study

The purpose of this study is to examine the financing mechanisms and the role of the African financial markets in the growth and development of SMIs on the continent. The main objectives of the case study are to:

- Review the challenges and opportunities of SMIs in Africa, as well as their financing environment, in relation to other jurisdictions such as South-East Asia.
- Evaluate the financing roles of the domestic money and capital markets in SMI financing.
- Evaluate the impediments and possible solutions to listing of small firms on the continent’s stock exchanges, in the quest to enhance the raising of long-term capital.
- Evaluate the impact of money-market and interest-rate policies on SMI development.
- Propose policy recommendations for addressing binding constraints and ease of access to sustainable finance for SMIs in Africa.

The study is based on desk research focusing on SMI access to finance in Africa and drawing on best practice and innovative approaches that promote access to financial services to SMIs in developing and developed countries. One of the limitations in the study is the failure in literature to distinguish between the financing needs of SMIs and the general SMEs. However, on the demand side, one important distinction in the financing needs of SMIs from that of SMEs is the gap in long-term capital equipment financing that require lumpy investments. The Manufacturing Extension Partnership (MEP) (2011) notes that the primary reason why the capital needs of SMIs are different from SMEs is that SMIs have greater need for fixed assets, particularly machinery and equipment.
II. Situation analysis of small- and medium industries in Africa

2.1 Characteristics of small- and medium industries

The enterprise sector in many African countries is highly dualistic, consisting mostly of informal micro enterprises, operating alongside large firms (United Nations Conference on Trade and Development (UNCTAD), 2001; Sleuwaegen and Goedhuys, 2002; Kauffmann, 2005). Hence, the definition of what constitutes micro SMIs varies from country to country and often the distinction is blurred. However, the most common definitions use employment and turnover as indicators of firm sizes.

In the context of Ghana, Soderbom and Teal (2004) categorize manufacturing firms into micro firms employing less than 6 persons, small firms employing 6 to 30 persons, medium-scale firms employing 31 to 99 persons, and large firms as those employing more than 99 persons. In South Africa, SMIs are defined in terms of the number of employees (5 to 100), the turnover and gross assets (Falkena and others, 2002). Similarly, in Uganda, SMIs are defined as having up to 100 employees (Kasekende and Opondo 2003). In Latin America, Peres and Stumpo (2000) report definitions of SMIs in terms of employment with maximum-size ranges of SMIs between 30 and 299 persons.

Most activities that can be categorized as SMIs are small and usually managed as sole proprietor with self-employment as a key element of such enterprises (Mead and Carl, 1998; Fafchamps and Quinn, 2011). According to Fafchamps and Quinn (2011), 26 per cent, 72 per cent and 63 per cent of the SMIs in Ethiopia, Tanzania and Zambia, respectively, are sole proprietors. They usually employ a few other people with working proprietors as the dominant category.

However, most enterprises have failed to offer better conditions of work. In the case of Ghana, employment was characterized by the lack of formal contracts and regular pay, nonexistent social protection and low profits and efficiency (Mensah, 2005). Similar characteristics were evident in South Africa where as Kesper (2000) observed, the majority of SMIs were micro and survivalist enterprises with no signs of enterprise growth, and employment was only by a minority medium-sized SMEs. Ebony Consulting International and the National Statistical Office (2000) found that about 80 per cent of the firms in Malawi were stagnant and served primarily as additional sources of income for the household.

The micro- and small enterprises have tended to specialize in trading activities or commerce, with very few in mining and manufacturing industries. In Malawi only 27 per cent of SMEs were found to be in the manufacturing sector with most activities concentrated in beer brewing and distilling, and bread and cake baking sectors (Ebony Consulting International and National Statistical Office 2000). It has been noted that whenever micro- and small enterprises were engaged in manufacturing activities, they mostly specialized in textile and wearing apparel, wood and forestry products, and food products and beverages (Mead and Carl, 1998; Fafchamps and Quinn, 2011).

Peres and Stumpo (2000) also found food and beverages to be the most dominant manufacturing activity among SMEs in Latin America, followed by chemical products.
Similarly, UNDP (2007) learnt that 23.2 per cent, 16.7 per cent and 15 per cent of SMIs in manufacturing were in textiles and apparel, metal and non-metallic products, and food and beverages sectors, respectively, in Malaysia.

Entrepreneurs take up activities where entry barriers are low because they have little money to invest in machinery, resulting in production of similar goods and competition for the same customers (Vandenberg, 2003). Table 1 shows the distribution of SMIs in SMEs in selected countries in Africa. Textile and wearing-apparel production is the main sector across the countries, and accounts for 44 per cent of SMEs in Zimbabwe.

### Table 1: Sectoral distribution of SMIs in selected countries

<table>
<thead>
<tr>
<th>Sector</th>
<th>South Africa</th>
<th>Swaziland</th>
<th>Lesotho</th>
<th>Botswana</th>
<th>Zimbabwe</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food and beverages</td>
<td>4.1</td>
<td>6.1</td>
<td>17.2</td>
<td>9.7</td>
<td>2.6</td>
</tr>
<tr>
<td>Textile/wearing apparel</td>
<td>8.9</td>
<td>22.0</td>
<td>21.4</td>
<td>14.1</td>
<td>43.8</td>
</tr>
<tr>
<td>Wood production and processing</td>
<td>2.8</td>
<td>13.0</td>
<td>2.8</td>
<td>0.5</td>
<td>12.8</td>
</tr>
<tr>
<td>Paper, printing and publishing</td>
<td>0.4</td>
<td>-</td>
<td>0.2</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Chemicals and plastics</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>0.3</td>
<td></td>
</tr>
<tr>
<td>Non-metallic mineral processing</td>
<td>0.8</td>
<td>0.7</td>
<td>1.5</td>
<td>1.9</td>
<td>1.2</td>
</tr>
<tr>
<td>Metal fabrication</td>
<td>2.0</td>
<td>1.4</td>
<td>1.2</td>
<td>1.9</td>
<td>6.4</td>
</tr>
<tr>
<td>Miscellaneous manufacturing</td>
<td>3.7</td>
<td>4.3</td>
<td>2.8</td>
<td>2.9</td>
<td>6.4</td>
</tr>
<tr>
<td>Construction</td>
<td>1.2</td>
<td>-</td>
<td>4.8</td>
<td>-</td>
<td>2.0</td>
</tr>
<tr>
<td>Total of MSEs</td>
<td>23.9</td>
<td>47.5</td>
<td>51.9</td>
<td>31.0</td>
<td>75.5</td>
</tr>
</tbody>
</table>


Oh (1994) observed a similar trend in South-East Asia where SMIs, apart from being involved in the labour-intensive sectors as mentioned above, also prevailed in industries of fabricated metal, machinery and equipment. In large Latin American countries with more developed industrial structures the SMIs tended to concentrate in foodstuffs, garment and textiles, chemical and plastic products, and machinery and equipment while in medium-size countries SMIs were in the food and chemical industries (Peres and Stumpo, 2000).

The concentration of SMI production in foodstuffs suggests a specialization in labour-intensive sectors, based on natural comparative advantages and with low economies of scale. Daniels (1999), found that SMIs in the manufacturing sectors in Kenya accounted for 2-11 per cent of enterprises and 1.9-11.8 per cent of total SME employment.

Small-scale firms have been identified with labour-intensive technologies as a way of generating employment, but they also seem to have limited capacity to perform well (Soderbom and Teal, 2004). SMIs exhibit high labour-capital ratios than larger industries (Kimuyu, 2002), partly due to the constraints faced in raising capital to invest in production processes.

Manufacturing firms in sub-Saharan Africa are mainly small with few assets and limited access to finance (Biggs and Shah, 2006). Most of the SMIs finance their start-up and growth from their own and internal resources. Fafchamps and Quinn (2011) notes that more than 83 per cent of the owners participated in the financing of the creation of their SMIs and retained earnings were a main source of funding for innovation adoption.

The other feature of SMIs is the high rate of entry and exit of firms in the sector. At any given period, new firms are being created, while others are closing; at the same time some
that are existing are contracting in size, creating a high ‘churning’ or turnover rate for the sector (Mead and Carl, 1998; Kesper, 2000; Vandenberg, 2003). The majority of SMIs are indigenous-African owned although in some countries minority ethnic groups are more important (Biggs and Shah, 2006).

2.2 Major challenges facing small- and medium industries in Africa

Literature suggests that SMIs experience several challenges relative to large enterprises including financing constraints, legal obstacles and the overall policy- and macroeconomic environment. These constraints restrain the growth of SMIs particularly in developing countries.

According to Beck and others (2005), the extent to which SMI constraints affect their growth is dependent on the size of the firm, with small firms consistently adversely affected by financial, legal and corruption problems. Nonetheless, most studies highlight the problem of financing as the most important constraint in the growth and performance of SMIs, especially in developing countries where financial systems remain underdeveloped. Beck and Demirgüç-Kunt (2006) find that the large, older and foreign-owned enterprises are more likely to report growth constraints, and that small firms mainly finance their investments from external sources.

Zavatta (2008) observed that in developing countries SMIs had great difficulty in obtaining the necessary financial resources to scale up and grow their business. While banks tended to focus on large enterprises, the microfinance institutions targeted micro-enterprises leaving the finance needs of middle-level enterprises to remain deficient (see figure 1). Most SMIs in Africa are found in this middle gap.

Figure 1: Small- and medium enterprises and financing structure

Most SMIs tend to use their own funds for start-up capital and investment expansion. Even in South-East Asian countries, there is evidence that most SMIs start their industries from own funds and expand through re-investment of their profits or additional personal savings; what with the share of banking-institution loans to SMIs being insignificant (Oh, 1994; Nichter and Goldmark, 2009). Banks are reluctant to lend to SMIs due to high risk, and the absence of specialized lending institutions to SMIs makes it worse. Literature on enterprise financing identifies three main obstacles that could prevent SMIs from obtaining adequate financing:
information asymmetries; higher risk associated with small-scale activities; and existence of sizeable transaction costs in handling SMI financing.

The other issue raised with respect to the difficulties of SMIs in obtaining finance from the banking system is their poor presentation of documents or business proposals/strategic plans, poor accounting or incomplete accounting (Oh, 1994). Cost of borrowing both in terms of interest rates and transaction costs may also be an issue. The mark-up on basic lending rates may be higher for loans extended to SMIs due to the high perceived risks (see also Kasekende and Opondo, 2003).

There is also a lack of long-term financing (Oh, 1994) with many SMIs depending on short-term bank credit to improve their working capital, which constrains SMIs in investing in production processes (machinery and equipment). It is the demand for long-term finance that distinguishes the financing needs of SMIs from other SMEs in other sectors of the economy (MEP, 2011).

Fafchamps and Quinn (2011) found an increased use of own sources in financing product and production innovations in African SMIs, with 88 per cent, 47 per cent and 79 per cent of SMIs in Ethiopia, Tanzania and Zambia, respectively, indicating that they had financed their investments in innovative production processes from retained earnings. Table 2 shows that in these three countries 88 per cent, 80 per cent and 86 per cent respectively, of SMIs financed their last investments (machinery, equipment or vehicles) from retained earnings.

The problem of external sources of finance for plant and equipment for SMIs is revealed by the low percentage of enterprises obtaining finance from banks and financial institutions, the highest being 12 per cent of industries in Ethiopia and as low as 4 per cent in Zambia. However, in the case of Tanzania and Zambia, a large proportion of SMIs indicated that they could borrow from a bank or non-bank financial institution, suggesting preference to self-financing (Fafchamps and Quinn, 2011).

Table 2: Sources of funding for machinery among small- and medium industries in selected countries (percentage)

<table>
<thead>
<tr>
<th>Source of finance</th>
<th>Ethiopia</th>
<th>Tanzania</th>
<th>Zambia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retained earnings</td>
<td>88</td>
<td>80</td>
<td>86</td>
</tr>
<tr>
<td>New capital from owners</td>
<td>9</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Friends and relatives</td>
<td>4</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Banks and financial institutions</td>
<td>12</td>
<td>6</td>
<td>4</td>
</tr>
<tr>
<td>Other</td>
<td>3</td>
<td>1</td>
<td>8</td>
</tr>
</tbody>
</table>

| Number of SMIs                     | 250      | 262      | 250    |

Source: Fafchamps and Quinn (2011).

Vandenberg (2003) and Nichter and Goldmark (2009) argue that the lack of collateral as well as the tenuous nature of the SMI business establishment is what makes access to bank credit difficult. Thus, while access to bank and trade credit is positively related to firm size, the smallest firms exhibit a much greater tendency to use purchase orders to secure irregular access to trade credit.
Only 25 per cent of SMIs in Kenya have had access to bank credit and this tended to be the situation mostly for the upper tier of small- and medium-manufacturing industries. Fafchamps and Quinn (2011) also found that a higher proportion of SMIs that obtained loans from financial institutions in Ethiopia, Tanzania and Zambia had to provide collateral compared to the proportions in China and Vietnam.

Access to equity markets is also a major challenge for SMIs. Some have attributed this to the strict listing requirements on major stock markets which are a deterrent to accessing long-term financing for SMIs (Oh, 1994). Besides, SMIs tend to be closed firms with sole proprietorship arrangement and hesitant to pursue joint ventures.

These challenges have led to the slow growth of SMIs in Africa. For example, only about 3 per cent of SMIs expanded beyond three employees after start-up (Nichter and Goldmark, 2009). In Malawi, small- and medium-scale manufacturing enterprises cited lack of finance and problems of availability of inputs as major constraints to their performance (Ebony Consulting International and National Statistical Office, 2000). Similarly, in Tanzania and Uganda, lack of access to finance, particularly long-term financing, was one of the constraints limiting the competitiveness of SMIs (United Republic of Tanzania (URT), 2003; Ministry of Tourism, Trade and Industry (MTTI) and United Nations Industrial Development Organization (UNIDO), 2007).

SME/SMIs also receive inadequate support services for technology, skills development and marketing. There is evidence that micro-enterprises and small firms are in a disadvantaged position in gaining access to inputs for several African and Caribbean countries, as provided by Mead and Carl (1998); McCormick and others (1997) for small- and medium-sized garment producers in Nairobi; and by Sleuwaegen and Goedhuys (2002) for manufacturing firms in Cote d’Ivoire. Biggs and Shah (2006) reveal that technical and management skills are low on average and absenteeism and acts of employee pilfering are numerous among the SMEs of sub-Sahara Africa. Product standardization is also relatively low which has implication on Africa products competitiveness.

Unfavourable legal, regulatory and economic environments and, in most cases, infrastructure development are well documented in literature as some of the challenges facing SMEs in Africa. In Burkina Faso and Namibia, obtaining a business licence can be a protracted process while in Zambia the Government waives licensing and registration requirements for SMEs in designated areas of its cities as a strategy for depressed-area development (Tonin and others, 1998; UNCTAD, 2001).

Nonetheless, compared to SMIs in China and Vietnam, Fafchamps and Quinn (2011) found low levels of registration and value added tax (VAT) registration in SMIs in Africa (Zambia and Tanzania). According to Beltchika and Stryker (2001), firms in Malawi were greatly constrained to fully utilize their capacity by unreliable public utilities such as telecommunication, electricity and water supply. In Tanzania and Zambia, although there was high use of electricity in the production process, a high proportion of SMIs did not have an account with the service provider (Fafchamps and Quinn, 2011). Similarly, in Uganda it was estimated that 77 per cent, 44 per cent and 16 per cent of large, medium and small enterprises respectively, had their own power generators as contingency to power failures and cost of electricity (MTTI and UNIDO, 2007).
III. Financing small- and medium industries in Africa

3.1 Formal financial systems and small- and medium-industry financing

3.1.1 The nature of formal financial systems in Africa and small- and medium-industry financing

The formal banking system is highly underdeveloped in developing countries and African countries in particular. According to Sacerdoti (2005) the key feature of the financial systems in Africa is that the stock of credit to the private sector remains low compared to the situation in other developing countries. The financial sectors tend to be highly oligopolistic and offer accessible financing products to large-scale industries. Studies show that most banking systems in Africa are highly concentrated (Chirwa, 2001; Mwega, 2011; Mwenda and Mutoti, 2011), with low levels of efficiency (Mlambo and Ncube, 2011) and high intermediation margins (Chirwa and Mlachila, 2004).

The financial sector in most African economies is characterized by very low levels of financial intermediation and weak capital markets, which cannot effectively supply the financial resources and other products needed by the private sector. In particular the SME sector, which generally lack the scale, collateral and relationships for formal financing (Tadesse, 2009). In most African countries, with the exception of Mauritius, Seychelles and South Africa, the ratio of M2 to GDP is low ranging from 15 per cent to 30 per cent (Sacerdoti, 2005).

In most African countries, the banking system also tends to be concentrated in urban areas, which increases the transaction costs of accessing financial services for SMIs in the rural areas. For instance, Mwega (2011) found that a high concentration of banks in the urban and rural areas were under-served in Kenya, hence banks had not attempted to mobilize the unbanked majority. In addition, most of the bank credit in African countries is directed towards the government sector due to the high demand of financing government budgets from domestic sources (Sacerdoti, 2005).

Most financial institutions have not been able to operate profitably with SMIs as their sole or major debt clientele, despite the interest premium based on higher risk and transaction cost. Small-business loans are regarded as opaque assets, constituting the main component of credit risk (Wattanapruttipaisan, 2003). Evidence suggests that banks in developing countries tend to be less exposed to SMIs, provide a lower share of investment loans, and charge higher fees and interest rates relative to large firms. At the same time, banks experience high non-performing loans lending to SMIs (Beck and others, 2008).

Often the banking system in Africa provides short-term credit facilities to enterprises in the form of overdraft facilities. For instance, in Zimbabwe, the bulk of short-term lending by commercial banks to the manufacturing sector is organized primarily around overdraft facilities and bankers acceptance (Fafchamps and others, 2005). Overdrafts represent a large proportion of the funds received by microenterprises not because these firms receive large

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1 M2 refers to money and quasi money; it comprises the sum of currency outside banks, demand deposits other than those of the central government, and the time, savings, and foreign currency deposits of resident sectors other than the central government.
overdraft facilities but because they receive little credit from elsewhere, except suppliers. Most SMIs obtain overdraft facilities rather than loans (Bigsten and others, 2003).

3.1.2 Experiences of small- and medium-industry financing from the banking system

There is ample evidence that access to bank credit is related to the size of firms. In a study of four African countries, Kenya, Tanzania, Zambia and Zimbabwe, it was found that the percentage of SMIs receiving bank credit ranged from 8.2 per cent in Zimbabwe to 24.6 per cent in Kenya (Biggs and Shah, 2006). Maeseneire and Claeys (2012) also noted that SMIs were more constrained in the use of collateral, long-term relationship and reputation, which eased information problems. Lack of collateral was the most constraint that SMIs faced in accessing lines of credit from the formal financial system (Oh, 1994; Falkena and others, 2002).

A study of manufacturing firms in six African countries (Burundi, Cameroon, Cote d’Ivoire, Ghana, Kenya and Zimbabwe) during the 1990s showed that among those firms which wanted a loan, small firms had substantially worse chances of getting a loan from the banking system than large firms (Bigsten and others, 2003). Mwega (2011) found there to be a reluctance to lend to SMEs, although some banks like Equity Bank and Kenya Commercial Bank were designing products that increased access to loans to SMEs/SMIs. Similarly, Fafchamps and others (2005) noted that the proportion of firms that obtained overdraft facilities, bank and non-bank loans increased with the size of the firms in Zimbabwe, with small industries being severely constrained in many ways. Vandenberg (2003) reported limited bank-loan usage among SMIs in Kenya and that usage tended to increase with the size of the firm. Small firms may well have been limited by the requirement to provide physical collateral in most cases.

According to Woodruff (2001), receipt of trade credit was positively correlated with the firm’s level of fixed assets and more common among firms with formal accounting systems in Mexico. This suggests that information matters in trade credit markets and that development of information institutions such as credit-reporting bureaus would have beneficial effects for microenterprises.

Financing constraint is particularly severe in start-up enterprises and relatively young firms (some 3 years old or less) in developing economies. Wattanapruttipaisan (2003) gives examples of Ghana, Sri Lanka and Tanzania where although start-up firms can obtain bank loans, the medium-sized enterprises and older firms have higher chances of getting a loan.

Several reasons have been attributed to the reluctance of banks to extend credit to SMIs including: (1) perceived high risks owing to insufficient assets and low capitalization, vulnerability to market fluctuations and high mortality rates; (2) asymmetric information with respect to accounting records, inadequate financial statements or business plans; and (3) administrative/transaction costs of lending or investing small amounts do not make SMI financing a profitable business (Abereijo and Fayomi, 2005). Oh (1994) argues that lack of collateral is the most important obstacle to SMIs in having access to the formal financial institutions.

In a study of six African countries, Bigsten and others (2003) observed that most lending was collateralized and the value of collateral was typically high, on average more than twice the...
value of the loan. However, in most low income countries, such collateral as land and buildings did not have good titles to real estate and so in the event of non-payment, there were delays in the exercise of contract rights to possess collaterals and liquidate the business (Wattanapruttipaisan, 2003).

There are several factors that lead to problems of access to bank loans by the SMIs both from the perspective of the banks and SMIs (Derreumaux, 2009). It is argued that SMIs lack corporate governance, equity and forward-looking vision while the banks are ill-equipped to supervise SMI loan-portfolio perspective of the banks, they do not have specialized staff and appropriate financing frameworks for SMIs. The problem of bank financing to SMIs is also exacerbated by the lack of credit-reference bureaus in Africa.

Although credit-information systems have been established in Kenya, Mozambique, Tanzania, Uganda and Zambia, more needs to be done to allow access to this information by the non-banking institutions. The Democratic Republic of Congo, Ghana, Guinea, Lesotho, Malawi, Sierra Leone, Tanzania, Uganda and Zimbabwe, all have zero per cent credit-bureau coverage (Sacerdoti, 2005). An international survey of SMI financing noted that more than two thirds of developing-country banks responded that the existence of a credit bureau in their country facilitates SMIs lending (Beck and others, 2008).

3.2 Microfinance development and small- and medium-industry financing

In the past two decades there has been growth of the microfinance institutions in most African countries as alternative vehicles for financing SMIs. However, there are several challenges that make credit from microfinance institutions not suitable for SMIs. First, the main limitation of microfinance institutions is that although they are accessible, their focus is on offering short-term loans to SMIs. The type of credit offered by microfinance institutions is suitable for the working-capital needs of SMIs but may not be suitable for SMIs requiring investments in plant and machinery. Rogerson (2001) asserts that after many years of microfinance operations, their impact on enterprise development and growth in Africa remains limited.

Secondly, most microfinance institutions tend to focus on the poor borrowers, mainly supporting working-capital requirements of enterprises with the objective of reducing poverty, and the size of loans are usually small to support sizeable investments (Hermes and Lensink, 2011). Thirdly, most of the microfinance institutions use group-based lending models which may not be appropriate for SMIs. Fourthly, most of the loans have short repayment schedules not appropriate with the medium- to long-term investment needs of SMIs. Fifthly, microfinance institutions tend to have limited capital and heavily rely on donor funds for their operations (Kasekende and Opondo, 2003; Kauffmann, 2005).

3.3 Access to government financing facilities

One of the ways that governments have helped in improving the financing opportunities of SMIs has been the establishment of specific funds to support investment needs of SMIs. These funds have been in the form of credit-guarantee schemes and direct-credit funds through government-owned institutions. In Zimbabwe, loans from non-financial institutions such as finance houses, building companies, pension funds and government credit programmes, although the second largest source of finance after supplier credit, are only
important for the largest firms (Fafchamps and others, 2005). South Africa has a number of guarantees and support programmes but the uptake is low (Underhill Corporate Solutions, 2011), partly due to low awareness of these funds by the SMIs.

Kasekende and Opondo (2003) note some of the support programmes that provide credit-guarantee funds to commercial banks to facilitate lending to SMIs and capacity-building in the area of business advisory services to SMIs. Funds for SMIs that have directly been implemented by government institutions tend to perform poorly and have high default rates due to poor governance and lack of performance targets. These funds are usually provided at interest rates below market rates, leading to questions about their sustainability. The funds also tend to have poor institutional structures for monitoring and loan collection; the loans are offered without proper risk assessment; and have poor delivery records.

Due to politicization of most government SMI support funds in Africa, they have had little success due to high default rates and high incidence of non-repayment loans. In addition, there was a general lack of awareness by SMIs of the existence of government support programmes specific to SMI financing needs. Underhill Corporate Solutions (2011), with respect to South African programmes, notes that surveys reveal a large proportion of SMIs not being aware of government support schemes thus leading to their low utilization. Similarly, in Rwanda, the utilization of the SME Guarantee Fund stood at 1.3 per cent due to complex application processes and the cost of accessing the fund (Republic of Rwanda, 2010).

### 3.4 Access to stock markets

Stock markets in Africa are relatively new. Most of the stock exchanges that exist in Africa were created after 1990. Out of 53 African countries, there are more than 20 active stock markets (UNDP, 2003). According to Wikipedia (2012) there are 29 stock exchanges in Africa representing 38 national capitals but only six of these were established prior to 1990. Some of the oldest stock exchanges include the Egyptian Exchange established in 1883, Johannesburg Stock Exchange (JSE) founded in 1887, Casablanca Stock Exchange founded in 1929, the Nairobi Stock Exchange established in 1954, Nigeria Stock Exchange founded in 1960 and the Stock Exchange of Mauritius (SEM) established in 1988.

Although there has been noticeable growth in stock markets on the continent in terms of numbers and market capitalization (Andrianaivo and Yartey, 2009), most of these markets are thin with the number of stocks listed as small as three firms. With the exception of South Africa, the markets are characterized by low capitalization and low liquidity. The South African Stock Exchange alone accounted for 75 per cent of the total Africa market capitalization (UNDP, 2003).

Table 3 shows the number of companies listed and traded on stock exchanges. In some of the countries, such as Namibia and Tanzania, more than 40 per cent of the listed companies are not traded. In addition, there are variations in the changes in the numbers of listed and traded companies, with more than half of the countries registering a decline in the number of traded companies. These figures suggest most entrepreneurs, be it small or large companies, are not keen to list on the stock exchanges in Africa as a vehicle for raising capital. In most of these small markets, the growth in the number of firms listed has mainly emerged from the privatization of state enterprises and not the transformation of private firms to public-listed firms.
Table 3: Number of companies on stock markets in Africa, 2009 – 2011

<table>
<thead>
<tr>
<th>Country</th>
<th>2009</th>
<th>2011</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>listed</td>
<td>traded</td>
<td>listed</td>
</tr>
<tr>
<td>Tanzania</td>
<td>15</td>
<td>12</td>
<td>17</td>
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<tr>
<td>Malawi</td>
<td>15</td>
<td>15</td>
<td>15</td>
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<tr>
<td>Zambia</td>
<td>20</td>
<td>20</td>
<td>21</td>
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<tr>
<td>Botswana</td>
<td>31</td>
<td>31</td>
<td>37</td>
</tr>
<tr>
<td>Namibia</td>
<td>33</td>
<td>25</td>
<td>32</td>
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<tr>
<td>Ghana</td>
<td>35</td>
<td>34</td>
<td>34</td>
</tr>
<tr>
<td>Tunisia</td>
<td>52</td>
<td>52</td>
<td>57</td>
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<tr>
<td>Kenya</td>
<td>55</td>
<td>52</td>
<td>58</td>
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<tr>
<td>Morocco</td>
<td>76</td>
<td>76</td>
<td>76</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>78</td>
<td>75</td>
<td>77</td>
</tr>
<tr>
<td>Mauritius</td>
<td>89</td>
<td>89</td>
<td>87</td>
</tr>
<tr>
<td>Nigeria</td>
<td>216</td>
<td>211</td>
<td>198</td>
</tr>
<tr>
<td>Egypt</td>
<td>373</td>
<td>322</td>
<td>213</td>
</tr>
<tr>
<td>South Africa</td>
<td>458</td>
<td>437</td>
<td>406</td>
</tr>
</tbody>
</table>


Most of the companies listed on African stock exchanges are large firms and tend to be dominated by the banking and insurance sectors, real estates, hotels and tourism, mining and metals (UNDP, 2003). These stock markets are inaccessible to SMIs as vehicles for raising capital, although this seems to be a problem even for large private firms.

Kasekende and Opondo (2003), in the case of the Uganda Stock Exchange founded in 1998, note that most SMIs were not able to take advantage of the Exchange because of listing rules regarding disclosure requirements, which require companies to provide credible information to investors. Furthermore, according to Maeseneire and Claeys (2012), SMIs face increasing difficulties in accessing capital markets relative to large firms for the following reasons: (1) floatation is expensive; (2) initial public offerings of smaller firms tend to be highly underpriced; (3) venture capital is expensive; and (4) SMIs are reluctant to sell equity to outsiders. Equity financing has its own limitations, especially in terms of the tight market-listing requirements and the possible loss of control to external investors (Wattanapruttipaisan, 2003).

The other constraints to participation of SMIs in stock exchanges relate to the cost of listing. Omran (2008), Fung and others (2007) and McKee (2003) all note that the cost of going public on the stock exchange includes cost of complying with securities regulations for initial public offers (preparation of prospectus and advisory fees to professionals, presentation of historical financial statements), cost of underwriting and the cost of underpricing the initial public offer.

The other feature of SMIs that limit their participation in the capital market is their corporate governance. Often the SMIs are operated as sole proprietor, a governance structure that is not compatible with participation in the stock markets. Derreumaux (2009) argues that SMIs lack key features of business such as human resources, accounting, administrative management and control functions, with business leaders being the sole decision makers in the firm.

Three countries in Africa have established alternative stock markets or boards with less restrictive listing requirements and rules to provide opportunities for SMIs to raise long-term...
capital. These alternative stock exchanges exist on the JSE as an alternative board, Alternative Stock Exchange (AltX), the SEM as the Development and Enterprise Market (DEM) and the Egyptian Stock Exchange as the Nile Stock Exchange. The differences with the main boards are in terms of minimum-capital requirements, proportion of shares in public hands, historical published financial statements (at least a year) and the listing fees. The AltX on the JSE serves as an incubator for the main board and focuses on small- and medium-sized growth companies eligible for listing if they appoint and retain the services of a registered designated advisor and satisfy directors’ education requirements.2

Similarly, the DEM on the SEM caters for SME companies that used to trade on the over-the-counter market, with minimum rules intended to provide opportunities for SMI listing (Virahsawmy, 2012).3 The Nile Stock Exchange also required SMIs to have an authorized advisor and there are 22 companies listed on this AltX (Omran 2008).4 There are 54 companies listed on the DEM, of which 15 are industries. The JSE AltX has 62 companies. The number of companies listed on alternative exchanges in Africa, similar to the main boards, is small relative to the population of SMEs. Although, the listing and disclosure requirements have been relaxed, the small number of companies listed on these alternative boards suggests that stock markets are of limited service to the financing needs of the many SMIs.

3.5 Access to venture capital funds

Venture capital involves the provision of investment finance to SMIs in the form of equity or quasi equity instruments not traded on a recognized stock exchange. The venture capitalists are actively involved in the management of the firms to ensure success of the investment and such investment provides long-term financing. The return for venture capitalists is in the form of dividends from investments and the sale of equity in the firm. Omran (2008) notes that venture capitalists reduce information asymmetries due to their participation in the management and monitoring of the firm, and that these may also improve the prospects of SMI listing on the stock markets.

Andrianaivo and Yartey (2009) note that private-equity funds remain small in Africa by international standards and are mainly concentrated in South Africa which accounts for 80 per cent of equity funds, followed by Nigeria accounting for 10 per cent. The extent to which private-equity funds are invested in SMIs in Africa is not known. In developing countries, the role of venture capital in financing SMIs has been very limited and working with SMIs in developing countries involves partnerships with entrepreneurs that are not familiar with financial prudence and practices, and involves more work for venture capitalists (UNCTAD, 2001). Marr and Chiwara (2011) observe that there is lack of an appropriate regulatory framework in African countries to enable the licensing and recognition of venture-capitalist firms.

3.6 Access to lease financing

Leasing is one of the types of financing that overcome the collateral problems that SMIs experience in financing. There are basically two types of lease arrangements.5 First, the

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2 See http://www.jse.co.za/How-To-List/AltX.aspx#dip.
3 See http://www.stockexchangeofmauritius.com/dem-listedcompanies#.
5 International Finance Corporation, Leasing in Development: Guidelines for Emerging Economies.
financial lease in which the lessee pays for use of the equipment with the option of purchasing it at the end of the lease. The term of the financial lease has duration equal to most of the economic life of the asset.

Second, the operating lease in which the lessee rents the equipment from the lessor and the lessor retains ownership and claims depreciation on taxes. An operating lease is a short-term lease that is cancellable by the lessor or lessee upon due notice to either party. However, there is low utilization of lease financing by both large industries and SMIs in developing countries, with leasing being only less than 2 per cent as a source of financing for SMIs compared to 15 per cent access to bank loans (Beck and Demirgüç-Kunt, 2006). The IFC (2010) observes that leasing and factoring as a source of finance for SMIs are underdeveloped in emerging economies.

Several studies conducted in Africa show that the leasing market is underdeveloped and where it exists it tends to serve large establishments. Mutesasira and others (2001) find that there is a huge demand for leasing among SMEs in Tanzania and Uganda but the share of lease financing to manufacturing industries remain insignificant. The extent to which the manufacturing industry’s access to lease financing in Africa is not well documented.

Nevertheless, the share of manufacturing in lease financing suggests that SMIs are at a disadvantage. For instance, in Ghana only 6 per cent of the value of leased equipment are in the manufacturing sector and 18.6 per cent in the construction and mining sectors (IFC, 2008). According to Sory (2005), leasing accounts for only 1 per cent of outstanding total credit to the private sector. In Rwanda, only 7 per cent of the assets financed under leasing are plants and machinery, with vehicles accounting for 65 per cent; and only 123 per cent of the leases are in manufacturing and mining sectors (IFC, 2009b).

### 3.7 Macroeconomic environment and the performance of small- and medium industries in Africa

The goals of enterprise development vary considerably among African Countries. For instance: the Ethiopian Government and Namibia emphasize the creation of an enabling environment by instituting market-oriented reforms, export promotion and institutional support (Tonin and others, 1998); in South Africa, SMIs are promoted as policy instruments to tackle the problem of employment growth (Kesper, 2000); and in Malawi, as drivers of inclusive private-sector growth and competitiveness (Government of Malawi, 2006). These policies and programmes for SMI development in most African countries fall principally under the portfolio of their ministries of industry and commerce or the equivalent.

In addition to financing issues, the World Bank (2000) observes that Africa lags behind the rest of the world on almost all dimensions of infrastructure development, especially when South Africa is excluded. Poor infrastructure such as technology, power, transport and telecommunication among others, is one of the main causes of the region’s low competitiveness. Inadequate infrastructure impedes the integration of domestic markets which translate to reduced production opportunities.

The situation in Africa is unlike the Singapore experience where strong industrial policy resulted in selective investments in skills, technology and infrastructure; or in Taiwan where

(Washington, D.C., 2009).
SMEs were supported with an array of technology, training, finance and export marketing policies and institutions (Lall, 2000). These market features combine to increase the uncertainty of business relationships and raise transaction costs of exchange in Africa. Coupled with the absence of a favourable macroeconomic framework, efforts focusing on SMI development are often frustrated.

Favourable macroeconomic policies are important for creating an environment that is conducive for promoting access to capital. There are several policies that some of the successful countries in East Asia introduced in the promotion of SMI financing. Firstly, one of the policy instruments that has encouraged commercial bank lending to SMIs in East Asian countries, is the minimum-requirement lending-ratio policy of the banks’ total credit to the SMI sector, with Indonesia, Korea, Malaysia, Taiwan and Thailand adopting such a policy (Oh, 1994).

Secondly, in some cases, the government establishes a number of credit schemes to the financial institutions to facilitate credit extension to SMIs. These are usually in the form of credit-guarantee schemes, with some guarantee schemes purposively meant for SMIs adopting new technology. More recently, in response to problems of SMI financing in Africa, the African Development Bank (AfDB) launched the African Guarantee Fund as an instrument for channelling guarantees and technical assistance to financial institutions in Africa, with the objective of generating enhanced growth in the SME sector (AfDB, 2012).

Thirdly, East Asian countries established several funds aimed at modernizing or building the capacity of SMIs. Similar schemes were introduced in Uganda (Kasekende and Opondo, 2003). Fourthly, macroeconomic stability, including low inflation and stable interest rates, is important in promoting a favourable environment for SME/SMI access to finance.

While a number of African countries have put in place SME development policies, they remain broadly strategic documents without policy actions. In addition, there is a tendency to assume that SMEs are a homogenous group requiring the same strategies to address the various challenges the sector faces. In most of the policies, there is no special recognition of the roles that SMIs can play in industrialization and no recognition of the special needs of their long-term financing. However, in the SME Policy in Tanzania, the role of SMIs in rural industrialization is highlighted but facilitating access to long-term finance is not one of the strategies articulated in the policy (URT, 2003). This is in contrast to the strategic positioning of SMIs in Asian countries such as Indonesia where the SMIs are at the core of harnessing the competitiveness of the manufacturing sector (Dhanani, 2000).

IV. Policy options for improving small- and medium-industry financing in Africa

This study has revealed that financing is one of the main constraints experienced by small firms in developing countries and in African countries. The difficulties of access to finance by SMIs in Africa are both supply-and demand-side issues. On the supply side, the main problem is that the financial systems in most African countries are underdeveloped and the formal financial systems are characterized by oligopolistic structures that tend to focus their services on large-scale firms and governments. The formal banking systems are reluctant to lend to the SMI sector as they perceive the sector as high risk and administratively costly.
Other markets such as capital, venture capital and leasing markets are thin and just developing on the African continent, and the structure of their services are not tailored to cater for the needs of SMIs. A number of countries have liberalized the financial sector, this in some way is leading to some of the financial institutions to design products for SMEs, but the long-term financing needs of SMIs are yet to be addressed.

On the demand side, the characteristics of SMIs in Africa make them unattractive to formal funding sources. Most of the SMIs are not formally registered or are registered as sole proprietors with very few equity-based SMIs, the governance structures are simplistic owner-manager, and do not have the appropriate financial systems – rarely account for their business operations. These problems are not specific to African SMIs, but there are developments in Latin American and Asian countries that show SMI access to financing can be improved.

On the policy side, very few African countries have designed policies for the promotion of SMIs. The discourse in the policy arena, development partners and the international community has been to look at SMEs in general without recognizing the special roles and needs of SMIs. In terms of financing needs, SMIs require to finance plant and equipment in addition to working-capital needs. Most of the strategies for the promotion of SME access to finance tend to focus on working-capital needs through short-term credit, ignoring capital-financing needs that are usually medium to long-term.

The financing of SMIs is complex as the needs vary from country to country, thus country-specific solutions are required to address these gaps. It is also important that the problem of financing SMIs must be addressed holistically. While increasing the volume of finance is necessary, addressing the technical needs of SMIs and ensuring the environment is conducive for profitable investments are equally important.

4.1 Policy and sectoral segmentation of small- and medium enterprises

The SME sector is usually segmented by size categories without paying attention to the nature of economic activities. Such segmentation has tended to homogenize challenges and solutions to SMEs as applying to SMIs. SMIs should be recognized as a special group of SMEs that is critical for industrialization in Africa, and that requires specific policies and incentives. Often the financing problems of SMIs are usually lumped together with other SMEs focussing on working-capital needs. In contrast, SMIs in addition to working capital require long-term financing to support investments in machinery and equipment. In order to promote small-scale industrialization in African countries, it will be important for governments to design policies and incentives tailored towards the promotion of SMIs, distinct from those that apply to SMEs in general. The focus on SMIs in Asian countries and designing specific policies for these industries has been key elements to their successful industrialization.

4.2 Credit-guarantee schemes and credit-ratio policy

The experiences in South-East Asia have demonstrated that credit-guarantee schemes to the financial institutions combined with the credit-ratio policy can greatly improve access to SMI financing. The cases documented by Oh (1994) demonstrate that the success of East Asian countries in reaching out to SMIs (with some programmes designed for technology-based SMIs) was based on the combination of credit guarantees and credit-ratio policies in different countries. Although some of the countries in Africa have put in place credit-guarantee
schemes, access remains limited partly due to lack of information, complex application processes and lack of specific policies that require a certain proportion of credit goes to SMIs for banks that are provided with the credit-guarantee funds.

While some of the banks in African countries administer credit-guarantee schemes, there is lack of information as banks do not make this information known for fear of attracting bad borrowers. There should be ways for banks to promote access to these services, for example, through working with private-sector associations such as the Chambers of Commerce and Industries and associations of industries.

4.3 Promotion of competitive banking sector

There is need to improve the supply-side issues in African economies. Competitive banking systems enable the banking sector to engage strategically with SMIs as the competition becomes stiff in corporate banking. As has been demonstrated in Latin American countries, banking finance to SMIs has become a strategic segment of commercial banks owing to competition in corporate-and retail-banking sectors (Stephanou and Rodriguez, 2008; Torre and others, 2008). In Argentina and Chile, large banks followed by public banks are the main players in SMI financing (Torre and others, 2008). The motivation for increased bank lending to SMIs include: perceived profitability of SMIs; interest in supporting SMIs that are linked to large customers of the banks with large corporations sometimes offering guarantees; strategic interest in the SMIs; and the intense competition and exposure of the retail-and corporate-banking sectors.

4.4 Creation of alternative stock exchanges

The existing rules and regulations on the region’s emerging stock markets do not suit the structure and nature of SMIs. The listing requirements in terms of minimum capital, minimum governance structures, the adherence to financial reporting standards, disclosure rules and the cost of listing all work against the prospect of SMIs listing on stock exchanges. Others have proposed the establishment of AltX which require different sets of regulations while protecting the interest of investors. For instance, the establishment of the AltX on the JSE, the DEM on the SEM and the Nile Stock Exchange in Egypt, with its different listing requirements including reduction in the minimum capital and reduction in the historical needs of information in the prospectus (Omran, 2008).

Nonetheless, the lack of participation of large enterprises as a way of raising capital on stock exchanges in most African countries, make the prospects of SMI participation on the AltX limited. It seems there is a general culture of enterprises in Africa to base their expansion on internally generated resources or credit facilities from the banking system than through equity markets which require good governance, accountability, public disclosure and transparency.

4.5 Creation of small- and medium-enterprise financial institutions

Some of the countries in Asia have created special financial institutions to cater for SMI needs (Oh, 1994; UNCTAD, 2001). However, as UNCTAD (2001) notes, such institutions introduced in some countries (such as Colombia, India, Japan, Pakistan, Republic of Korea and Turkey) have had mixed success with some experiencing problems of poor loan portfolio performance, declining profitability, and becoming unsustainable. There is however, a danger that as such institutions attempt to improve their performance, they tend to diversify into
providing services to large enterprises and heavily rely on low cost-funding from government and donors.

4.6 Promotion of venture capital markets

There is a lack of venture capitalists in most African countries and lack of an appropriate legal framework for their operations. Most of the venture capital funds that exist are supported by donors and the existence of private-venture capitalists is limited. There is therefore need to promote venture capitalists in African economies. Nonetheless, for it to flourish, it will require SME/SMIs in Africa to seek equity-based registration of their enterprises, and to move beyond sole proprietorships.

4.7 Promotion of leasing

This is an important market for SMIs as lease financing does overcome the problem of collateral that SMIs experience in accessing finance from the formal financial systems. This type of financing is still underdeveloped in Africa and often only accessible to large firms, and mostly financing vehicles rather than plants and equipment. The AfDB is supporting a leasing programme in Mauritania through a line of credit where the SMEs are the main market in the agro-business sector, tourism, construction and transportation (AfDB, 2012). Such programmes need to be targeted at the small- and medium-scale industries.

4.8 Promotion of credit reference bureaus

The current coverage of credit reference bureaus in Africa is limited and this limits the extent to which the financial sector can extend credit to SMIs. Credit reference bureaus reduce the screening cost of SMIs by the financial institutions. This requires appropriate legislation and regulatory framework.

4.9 Promotion of business support services

There is need to intensify efforts to promote business support services for SMIs with a view to upgrading them to sound and sustainable business entities. These services should include accounting, strategic marketing and management, and financial literacy. The SMIs must enter the formal sector – equity-based registration, maintenance of accounting records, maintaining auditing accounts, compliance with the tax system, and having clear strategic focus of the business.

Overall, the problem of access to financing for SMIs is a complex one from both supply- and demand sides. This suggests the need for well-coordinated and integrated strategies that address both the demand-side issues and the supply-side concerns of financing. On the supply side, issues of concern such as governance, risk reduction and accountability need to be addressed to reduce the need for collateral. There is greater need for financial institutions to design products tailored to SMIs.
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