



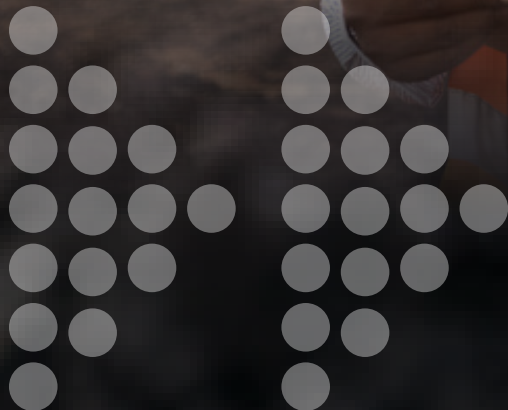
THE AFRICAN CAPACITY
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FONDATION POUR LE RENFORCEMENT
DES CAPACITES EN AFRIQUE

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Policy Brief N° 5 :
Empowering the Small and Medium
Business Ecosystem in Africa:
A Holistic Approach to Overcoming
Capacity Challenges
2024





Key takeaway

Small and Medium-sized Businesses (SMBs) are central to Africa's economy, driving employment and contributing significantly to Gross Domestic Product (GDP). They operate within a complex ecosystem that includes a range of stakeholders from financial institutions to regulatory bodies. Critical challenges such as limited access to finance, barriers to market entry, skill gaps, and infrastructural deficits hinder SMB growth. To counter these obstacles, a comprehensive approach is necessary, one that integrates financial inclusion strategies, promotes entrepreneurship education, boosts infrastructure development, and eases market access. This approach will ensure the scalability and sustainability of SMBs across the continent, leveraging their potential to drive economic development.



The issue

Small and Medium-sized Business (SMBs) are a crucial component of Africa's economic landscape, representing an overwhelming majority of businesses and playing a significant role in employment and GDP. According to the World Bank¹, small businesses account for 90% of all businesses on the continent highlighting the sector's vast presence and potential impact on the region's economy. SMBs in Africa are responsible for more than 80% of the continent's employment and contribute to 60% of its GDP (ILO 2019)². This data underscores the critical role that SMB play not just in job creation but also in economic resilience and innovation, driving forward Africa's economic growth and development.

For them to further play that important role, they need a conducive ecosystem. SMB ecosystems in Africa comprise an intricate network of entities including SMBs themselves, financial institutions, supply chain actors, service providers, and regulatory bodies. These ecosystems are characterized by a dynamic interplay between SMBs and various supporting services and infrastructural elements, all of which are crucial for the businesses' growth and sustainability. The concept of SMB ecosystems emphasizes the interconnectedness of these elements and highlights the importance of a supportive environment for SMB development.

However, the potential of SMB ecosystems in Africa is not fully realized, representing a significant missed opportunity for the continent's development. Many programs aimed at supporting SMBs often focus narrowly on the businesses themselves without addressing the broader ecosystem in which they operate. This oversight can lead to suboptimal outcomes, as the success of SMBs is intricately linked to the health and functionality of the entire ecosystem, including access to finance, regulatory support, market access, and the availability of supportive services and infrastructure.

Strengthening SMB ecosystems in Africa is not just about enhancing individual businesses but about fostering an environment that collectively uplifts all ecosystem components. As Africa moves towards greater economic integration with initiatives like the African Continental Free Trade Area (AfCFTA), the role of SMBs becomes even more critical. The AfCFTA aims to create a single continental market for goods and services, offering significant growth opportunities for African SMBs. For the AfCFTA to be a success, it is imperative to strengthen the SMB ecosystems, ensuring that SMBs are well-positioned to capitalize on the opportunities presented by this continental free trade area.

1 <https://www.worldbank.org/en/topic/smefinance>

2 ILO. 2019. Small matters: Global evidence on the contribution to employment by the self-employed, micro-enterprises and SMEs. Review of. *Geneva: International Labour Organization (ILO)*.

This policy brief provides an analysis of capacity issues within the SMB ecosystems in Africa, spanning dimensions such as finance access, support architecture, policy frameworks, markets, human capital, infrastructure, and research and development. It also offers a set of strategic policy recommendations aimed at addressing these challenges and fostering the growth and resilience of small and medium-sized businesses across the continent.



Capacity issues in the African SMB ecosystems

Finance

SMBs in Africa face several capacity challenges that hinder their access to finance. For SMBs, the primary challenges include inadequate financial records and management skills, which make it difficult for financial institutions to assess their creditworthiness. The lack of formal financial documentation and limited assets for collateral further exacerbates their difficulty in securing loans. On the side of financial service providers, the capacity challenge lies in their risk assessment and lending processes, which are often not tailored to the unique circumstances of SMBs. Traditional lending criteria rely heavily on collateral and detailed financial histories, which many SMBs cannot provide, thus limiting the providers' ability to effectively serve this market segment.

Other stakeholders, including government and regulatory bodies, development agencies, and support institutions, also face capacity challenges that impact SMBs' access to finance. For example, regulatory frameworks may be overly stringent, and support programs might not have the reach or resources to effectively assist SMBs. Financial education providers may struggle to address the diverse needs of SMBs across different sectors, and technology and infrastructure providers may find it challenging to extend their services to all areas where SMBs operate.

Markets

For SMBs, the primary challenge in market access lies in reaching potential customers, both locally and internationally. High entry barriers, such as complex regulatory requirements, tariffs, and non-tariff barriers, can restrict SMBs' ability to enter new markets. Additionally, limited access to market information, such as consumer trends and preferences, and the lack of a well-established distribution network further exacerbate these challenges. Competition, particularly from larger, more established firms and international companies, can be fierce, often leaving SMBs struggling to secure a foothold in their desired markets. The capacity to innovate, differentiate products, and adapt to changing market dynamics is crucial for SMBs to remain competitive.

Government and regulatory bodies play a critical role in shaping the market access landscape for SMBs. Their challenge lies in creating a conducive environment that facilitates SMB participation in both local and international markets. This involves reducing bureaucratic hurdles, negotiating favorable trade agreements, providing incentives for SMBs, and implementing policies that protect SMBs from unfair competition practices. Ensuring transparency and fairness in the regulatory framework is essential for enhancing market access and competition.

Trade associations and business support organizations are directly impacted by the challenges of market access and competition. Their capacity to support SMBs is tested by the need to provide relevant, timely market intelligence, networking opportunities, and advocacy services. These organizations must have the resources and networks to effectively assist SMBs in navigating market entry processes and competing against larger entities.

Financial service providers also play a role in SMBs' ability to access markets and compete. Access to finance enables SMBs to invest in market research, product development, and

marketing strategies that are essential for market penetration and competitive positioning. The challenge for financial institutions lies in offering financial products and services that are tailored to the unique needs of SMBs, including trade financing and credit facilities that support market expansion activities.

Human capital

Skill shortages represent a critical capacity challenge within the African SMB ecosystem, affecting multiple stakeholders and impeding business growth and innovation. For SMBs, the challenge is twofold. Firstly, there's a lack of skilled labor, which hampers operational efficiency and competitiveness. SMBs often struggle to find employees with the necessary technical skills, industry knowledge, and business acumen. This shortage can limit their ability to innovate, expand into new markets, and improve productivity. Secondly, SMB owners and managers themselves frequently face gaps in their own skills, particularly in areas like financial management, marketing, strategic planning, and digital literacy. These deficits can hinder effective decision-making and business growth strategies.

Educational institutions and training providers are directly impacted by this challenge, as they are tasked with equipping the workforce with relevant skills. The capacity issues here include aligning curricula with industry needs, providing practical, hands-on training, and ensuring access to education and vocational training across diverse geographic and socio-economic groups. Bridging the gap between the skills taught in educational settings and those demanded by the modern workplace is crucial.

Government and regulatory bodies also play a significant role in addressing skill shortages. The challenge for these stakeholders lies in creating policies and initiatives that promote skills development, support vocational and tertiary education aligned with market demands, and encourage lifelong learning and upskilling among the existing workforce. Implementing effective labor market policies to match skills supply with demand is essential for mitigating skill shortages.

Support organizations, such as industry associations, business incubators, and NGOs, are affected by skill shortages in their efforts to assist SMBs. These entities often provide training and development programs, but the breadth and depth of skill shortages can overwhelm their resources and capacity. Tailoring programs to the specific needs of diverse SMBs and scaling these initiatives to reach a broader audience present ongoing challenges.

Infrastructure

Infrastructure deficits pose a significant capacity challenge across the African continent, impacting the growth and sustainability of small and medium enterprises (SMBs) and the broader ecosystem supporting them. For SMBs, the lack of reliable infrastructure—ranging from inadequate transportation networks and poor road conditions to erratic power supply and limited access to digital technologies—directly affects their operational efficiency, productivity, and ability to scale. These deficits increase the cost of doing business, limit access to markets, and constrain the delivery of products and services, thereby stifling competitiveness and growth.

Government and regulatory bodies face the challenge of prioritizing and investing in infrastructure projects that can have the most significant impact on economic development, including SMB growth. The capacity issue for these entities lies not only in allocating resources but also in ensuring that infrastructure development aligns with the needs of SMBs and the broader business community. Effective public-private partnerships and policies that encourage investment in critical infrastructure are essential for addressing these deficit.

Furthermore, The rapid evolution of technology, particularly in artificial intelligence (AI), poses a dual challenge and opportunity for Africa's SMBs, necessitating an embrace of digital transformation to leverage efficiency and innovation gains. However, the digital divide, infrastructure deficits, and lack of resources hinder SMBs' capacity to adopt such technologies. Policymakers and ecosystem stakeholders thus need capacity to adapt regulatory frameworks and foster an environment conducive to technological uptake, ensuring equitable access and digital literacy among SMBs to harness the full potential of AI advancements in driving economic growth and competitiveness.

Policy frameworks

Navigating the regulatory and compliance landscape presents a significant capacity challenge within the SMB ecosystem, impacting various stakeholders in distinct ways. SMBs themselves often find themselves at a disadvantage, struggling to understand and comply with an array of complex regulations that span taxes, labor laws, environmental standards, and industry-specific guidelines. This challenge is compounded by the limited resources and expertise available to many SMBs, making compliance a daunting task.

For government and regulatory bodies, the capacity challenge revolves around crafting regulations that protect public and economic interests while not stifling SMB growth. The effectiveness of these bodies is tested not only in the creation of these regulations but also in their ability to communicate and facilitate compliance among SMBs, requiring a deep understanding of the unique challenges faced by this sector.

Financial service providers, essential to the SMB support structure, face the dual challenge of adhering to their regulatory mandates while assessing the compliance of SMB clients. The capacity issue here lies in developing lending criteria and risk assessment processes that adequately consider the SMBs' unique compliance challenges, balancing risk management with the need to support SMB growth.

Support institutions, such as business associations and advisory services, are tasked with providing SMBs with the knowledge and tools to navigate regulatory requirements. Their capacity to effectively support SMBs hinges on their ability to stay current with regulations and translate this knowledge into practical, accessible advice for a diverse range of SMBs.

Support architecture

Support actors in the SMB ecosystem, such as incubators, accelerators, industry associations, and networks, play a pivotal role in fostering entrepreneurship and innovation across the African continent. However, their ability to effectively nurture and empower SMBs is often hampered by a range of capacity challenges.

One of the primary issues these actors face is resource limitations, both in terms of finances and human capital. This constraint restricts their capability to offer extensive and highly specialized support tailored to the varied needs of SMBs, including startup grants, access to cutting-edge facilities, and expert mentorship. Furthermore, the challenge of scalability and reach is particularly acute in the diverse and expansive African landscape, where extending services to SMBs in remote or underserved areas is crucial for inclusive growth.

The dynamic nature of global and local markets necessitates that these support actors remain agile and continuously adapt their programs to stay relevant. Keeping pace with industry trends, technological advancements, and evolving market demands requires a proactive and innovative approach to program development, ensuring that SMBs receive the most current and impactful support.

Moreover, building and maintaining a robust network that can offer tangible value to SMBs is essential for industry associations and networks. This involves not just connecting SMBs

with potential partners and markets but also facilitating meaningful collaborations with larger corporations, academic institutions, and government bodies. The ability to effectively engage and mobilize a diverse range of stakeholders is critical for creating a conducive environment for SMB growth and development.

Another significant challenge lies in measuring the impact of their initiatives on SMB success and growth. Developing effective metrics and gathering the necessary data to evaluate the efficacy of their programs can be both resource-intensive and complex. However, it is imperative for continuous improvement, demonstrating value to existing and potential donors, and ensuring that interventions are aligned with the needs of the SMB sector.

Research and Development

Research and Development (R&D) within the SMB ecosystem faces numerous capacity challenges, particularly in the context of the African continent. These challenges stem from a variety of factors that collectively impede the ability of SMBs to engage effectively in R&D activities, which are crucial for innovation, competitiveness, and long-term growth.

One of the fundamental issues is the limited access to funding specifically earmarked for R&D. SMBs often operate with constrained budgets, making it difficult to allocate substantial resources to R&D initiatives that may not yield immediate returns. This financial limitation is further exacerbated by the scarcity of external funding opportunities, such as grants or subsidies, which are specifically designed to support R&D within the SMB sector.

In addition to financial constraints, there's a notable shortage of skilled personnel with the expertise required to conduct high-quality R&D. This skill gap is partly due to the broader challenges of the education and training systems in many African countries, which may not adequately prepare graduates for the specific demands of R&D work within SMBs. Consequently, SMBs struggle to recruit and retain individuals capable of driving innovative R&D projects, hindering their capacity to develop new products, services, or processes.

Collaboration between SMBs and research institutions, such as universities or specialized research centers, is often limited. These partnerships are essential for sharing knowledge, resources, and expertise, yet various barriers, including bureaucratic hurdles, intellectual property concerns, and a lack of mutual understanding of needs and capabilities, can prevent effective collaboration. The absence of strong linkages between academia and the SMB sector restricts the flow of innovation and the translation of research findings into commercial opportunities.

Infrastructure for R&D is another area of concern. Many SMBs lack access to specialized facilities and equipment necessary for conducting advanced research. This infrastructure gap is particularly acute in sectors that require significant capital investment in laboratory space, technology, or equipment, making it challenging for SMBs to engage in cutting-edge R&D activities.



Main policy recommendations

Focus on integrating innovations for broader financial inclusion and establishing risk-sharing mechanisms to encourage credit provision by banks. At the heart of the SMB ecosystem lies the pressing need for robust financial access. A future-forward approach harnesses the power of fintech, a sector in which Africa has already demonstrated innovation and leadership. By embedding fintech solutions within SMB operations, it will be possible to unlock a door to wider financial inclusion, bypassing traditional barriers of brick-and-mortar banking. Moreover, risk-sharing facilities emerge as a vital tool in this financial

landscape, encouraging banks to extend credit lines by mitigating their risks. This dual strategy of embracing technology and sharing risk paves the way for a more resilient and accessible financial environment for SMBs.

Promote entrepreneurship education, provide continuous professional development for SMB owners, and align vocational training with SMB needs. The human element — entrepreneurial acumen and managerial expertise — is the bedrock upon which SMBs are built. Cultivating this talent starts with entrepreneurship education, integrating practical business skills into the national curriculum to nurture a culture of innovation from the ground up. But learning cannot be confined to the classroom. Continuous professional development for current SMB owners and managers is paramount, ensuring that they are equipped with the latest in financial management, strategic planning, and digital literacy. Such an approach guarantees that SMBs don't just survive but thrive in a fast-paced business world. Finally, it is equally important to improve vocational and technical training by aligning it with identified needs of SMBs. This alignment is pivotal to nurturing a workforce that is not only competent in the present climate but also adaptable to future market shifts.

Expand infrastructural development and ensure readiness to embrace the digital revolution. A resilient SMB ecosystem demands a backbone of reliable infrastructure. Strategic investment in transport, energy, and communication networks is not just a capacity enhancement measure; it's a catalyst for transformation, enabling SMBs to optimize operations and scale up with confidence. Complementing this is the need for SMBs to embrace the digital revolution. Support for digital transformation opens a realm of possibilities, from e-commerce to global connectivity, positioning African SMBs on the world stage.

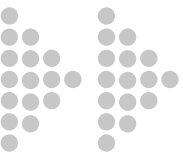
Facilitate market access and growth for SMBs. Firstly, trade facilitation needs to break down barriers and streamline export/import procedures, enabling seamless cross-border commerce. Investing in regional cooperation and upgraded infrastructure further enhances connectivity and logistical efficiency. Secondly, enhanced market information access empowers SMBs through comprehensive data systems and digital platforms. These platforms disseminate targeted insights gleaned from market trends and opportunities, while partnerships with research institutions translate raw data into actionable information.

Improve policy and regulatory frameworks to ensure they support the ecosystem. Government agencies should establish SMB Regulatory Clarity Initiatives, simplifying regulations and providing accessible online resources. Education and training tailored to SMBs are essential, with collaboration with industry associations for effective delivery. Regulatory Impact Assessments should evaluate new regulations' impact on SMBs, balancing growth and public interests. Regulatory Compliance Assistance Centers staffed with experts should offer personalized guidance. Financial incentives, such as tax breaks and grants, can motivate SMBs, with financial service providers offering support. Increased collaboration between government and industry associations would ensure relevant regulations, with feedback mechanisms promoting transparency. Furthermore, digitalization can also streamline compliance processes.

Cultivate innovation in small businesses by fostering a supportive ecosystem. One of the key strategies to achieve this is by creating dedicated funds and tax incentives specifically for research and development. This financial support will encourage SMBs to invest more in innovative projects and ideas. In addition to financial incentives, it is equally important to build bridges between SMBs and research institutions. The establishment of collaborative platforms can serve as a conduit for knowledge exchange and joint ventures, thereby accelerating the pace

of innovation. Lastly, the infrastructure plays a pivotal role in nurturing innovation. By investing in R&D infrastructure that is accessible to SMBs, such as shared laboratories and technology hubs, it would be possible to provide these businesses with the resources they need to experiment, iterate, and ultimately, innovate. This triad of strategies - funding, collaboration, and infrastructure - can significantly boost the innovative capacity of SMBs.

Adopt an ecosystemic approach. Governments and policymakers should implement holistic policies that address multiple facets of the SMB ecosystem concurrently. For example, this includes simplifying business registration and reducing bureaucratic hurdles to encourage formalization, while also moderating fiscal policies to alleviate undue tax burdens on SMBs. In parallel, enhancing access to finance through innovative lending models and support programs is crucial, but it must be complemented by substantial investments in infrastructure, including transportation, digital connectivity, and reliable power supply, to ensure SMBs can effectively produce, market, and distribute their products and services. This holistic strategy ensures that efforts in one area are not undermined by challenges in another, paving the way for a robust and resilient SMB ecosystem that can drive sustainable economic development across the continent.



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