Micro, Small and Medium-Sized Enterprises and Non-Tariff Barriers in African Trade

By:

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Introduction

Micro, Small and Medium-sized Enterprises (MSMEs) play fundamental role in job creation and economic development in many countries. MSMEs account for about 90% of businesses and generate more than 50% of employment worldwide, with the formal Small and Medium-Sized Enterprises (SMEs) contributing to about 40% of national income (gross domestic product (GDP)) in emerging economies. Accordingly, the UN General Assembly set aside 27 June as the MSMEs Day to highlight their contribution to sustainable development and the global economy. The Economic Commission for Africa (ECA) estimates that 80% of African economies are SMEs, out of which 70% of them are in the informal sector. Thus, SMEs will play vital role in the uptake of opportunities afforded by the African Continental Free Trade Area Agreement (AfCFTA). Notably, intra-Africa trade in pre-AfCFTA era was characterized by high tariffs and stultifying non-tariff barriers (NTBs). While AfCFTA aims to eliminate over 90% of tariffs line, the elimination of NTBs will be challenging because of poor development characteristics. Hence, existing barriers encountered by the MSMEs in intra-African trade will not disappear overnight if not comprehensively addressed. Consequently, this article seeks to proffer action plans to be implemented at the national, regional and continental levels to assist MSMEs to contribute to the realization of sustainable development and the underlying sustainable development goals (SDGs).

Classification, Significance and Constraints

SMEs describe non-subsidiary and independent firms which employ a limited number of staff, with the total number differing across countries. MSMEs include self-employed persons, family businesses, partnerships and entities engaged in an economic activity. In terms of the threshold (of revenues, assets or a number of employees), micro enterprises cover maximum of 10 employees - 0-9 employees; small enterprises do not exceed 50 employees - 10-49 employees; and medium-sized enterprises have 50-249 employees or below 250 employees. While 250 employees are usually the upper limit, the United States considers SMEs as firms with fewer than 500 employees. Other determinants of the characterization of MSMEs are, asset and revenues threshold; sectorial peculiarities; autonomous nature and/or affiliated to another company; partner enterprises or otherwise; and whether it is linked enterprises (i.e. linked with another enterprises).

In Nigeria, SMEs cover businesses with turnover of less than N100m per annum and/or less than 300 employees, and constitute approximately 96% of Nigerian businesses. In South Africa, under the Revised Schedule 1 of the National definition of Small Enterprise, there is an amendment to the Schedule of the Small Enterprise definition as contained in the National Small Enterprise Act, 1996 (Act No. 102 of 1996), read with the National Enterprise Amendment Act, 2003 (Act No. 26 of 2003) and the National Small Enterprises Act, 2004 (Act No. 29 of 2004) so that SMEs are defined based on ‘total full-time equivalent of paid employees’ and ‘total annual turnover’. This means that the ‘total gross asset value’ is not relevant in the definition, while the size category (‘very small enterprise’) collapsed into the ‘micro enterprise’ category.

MSMEs provide important benefits to the economy in many ways. Broadly, MSMEs contribute to the GDP through the output of goods and services. Secondly, MSMEs constitute an engine for job creation in many sectors. Thirdly, MSMEs constitute the vehicle for poverty reduction through employment. Also, MSMEs foster the development of a reservoir of skilled and semi-skilled workers which provides the building block for future industrial expansion. Moreover, MSMEs offer the opportunities to develop and contextual adaptation of technological innovation. Furthermore, MSMEs strengthen forward and backward linkages between economically and geographically diverse sectors of the economy. Additionally, they provide a fertile ground for the development of entrepreneurial and managerial skills that stimulate economic development. These benefits are crucial to African development.

In recognition of the above, the 20th Ordinary Session of the African Union (AU) Conference of African Ministers of Industry (CAMI 20) identified the crucial role of private sector-led SMEs in sustainable industrialization. Consequently, the AU Commission developed an SME Development Strategy and Action Plan to promote intra-African trade by integrating African MSMEs into regional and global value chains. The AU SME Strategy aims to ‘develop competitive, diversified and sustainable economies underpinned by dynamic, entrepreneurial and industrial sectors that generate employment, reduce poverty and foster social inclusion’.

Additionally, SME Strategy (including the Integrated Program Delivery Framework for the Implementation of the AU SME Strategy) supports ‘Enterprise Africa Network’ (EAN) which promotes a ‘Pool of competitive SMEs’ to make African SMEs regionally and globally competitive. Through EAN, SMEs can receive support from a Pool of accredited Business Development Organisations to build competitive capacity, networking, collaboration, alliances, and partnerships across multiple frontiers. This effort equally supports women entrepreneurs, thereby complementing the declaration of the AU Assembly of Heads of State and Government in February 2020 to designate the years 2020 to 2030 as the Decade of Financial and Economic Inclusion for African Women. The essence is to scale up sustainable development in inclusive and gender-sensitive way.

Also, SMEs are captured in the AU Commission Digital Transformation Strategy for Africa. As part of the AU integration agendas, the Digital Transformation Strategy for Africa builds on the existing initiatives and frameworks (such as AfCFTA and the Free Movement of Persons regime) to support the development of a Digital Single Market for Africa, with SMEs providing important partnership.

Despite these efforts, MSMEs continue to encounter diverse barriers in intra-African trade. More pungently, the increase in the number of SMEs in business is almost proportional to the uptick of SMEs' failures and closures. It is estimated that the average business failure rate in Africa is over 54% with countries such as Ethiopia and Rwanda recording 75% of SMEs failures. In Nigeria alone, over 1.9 million SMEs have closed since 2017 due to harsh economic conditions. While COVID-19 exacerbated their precarious situations, a survey on the MSMEs' outlook in Kenya, Nigeria and South Africa indicates that their conditions have not improved post-COVID. Specific barriers faced by MSMEs include: poor access to finance; poor infrastructure; multiple taxations; low technological upgrade; and legal, regulatory and policy frameworks that are largely unsupportive. Other barriers are, (1) crime and corruption; (2) capacity constraints; (3) poor management skills; (4) difficulty in accessing cross-border markets; (5) poor customers' relationship; (6) government bureaucracy; and (7) the excessive costs of regulatory compliance. Eliminating these barriers require actions on multiple fronts to foster MSMEs uptake of AfCFTA's opportunities and capacity to contribute to sustainable development. Arguably, enhanced uptake of such opportunities will promote the realization of multiple SDGs. Successful MSMEs, for instance, facilitate the realization of SDG 1 on 'no poverty'; SDG 2 on 'zero hunger'; and SDGs 1-2 can help to achieve SDG 3 on 'good health and wellbeing'. Support for women SMEs fosters the achievement of SDG 5 on 'gender equality' in addition to SDGs 1-3 above. Overall, the progress made in these SDGs has positive impacts on other SDGs.

Action Plans

Multiple action plans are required to foster MSMEs uptake of cross-border opportunities. First, registration procedures across national jurisdictions for MSMEs should be simplified, less costly and cumbersome. Costly and cumbersome registration procedures are antithetical to business growth, innovation, and creativity.

Secondly, MSMEs need secure access to finance to fund their business activities. Banks are generally reluctant to grant credit to SMEs because of fear of business failures and consequent loss of underlying credit. According to International Finance Corporation (IFC), 65 million firms (or 40% of formal MSMEs) have an unmet financing need of $5.2 trillion every year. The financing gap is even higher when informal SMEs are included. While blended finance constitutes an innovative solution to financing needs in addition to existing financing options, it is usually not predictable. The African Development Bank (AfDB) is scaling up support for SMEs across many countries. In Nigeria, AfDB signed an agreement with the First City Monument Bank for a $50 million credit to support SMEs and women-empowered enterprises. Similarly, the IFC's Small Loan Guarantee Program provides innovative financing, access to financial services and risk-sharing support to SMEs. IFC has committed $172 million under the Small Loan Guarantee Program to 11 financial institutions, including Union Bank of Nigeria, Société Ivoirienne de Banque Côte d'Ivoire, and Atlantic Business International which (i.e. the latter) has subsidiaries in many countries including Benin, Burkina Faso, Côte d'Ivoire, Guinea, Mali, Niger, Senegal and Togo. These financing solutions undoubtedly reduce the acute financing gap experienced by African SMEs, but it has not eliminated the financing constraints. More needs to be done to broaden the financing options. Most importantly, financing is insufficient if it is not contextualized within the broader constraints experienced by SMEs (e.g. taxes, capacity constraint and difficult business environment).

Consequently, MSMEs require tax incentives that are pro-business in addition to supportive finance. Pro-MSMEs tax regime include: (1) eliminating multiple taxations; (2) provision of tax incentive schemes; (3) simplified, transparent, and predictable payments; (4) pioneer status for qualifying MSMEs in strategic and high growth sectors; and (5) tax incentives for capital acquisitions, equipment fabrication and import substitution activities.

Moreover, capacity building, technical assistance and sensitization complement SMEs financing. These factors ensure good business management, proper utilization of the loans granted, reduction of bank exposures to bad loans and possibility of further loan facility in the future. MSMEs can also benefit in managing contract enforcement and dispute resolution under these factors. Sensitization is fundamental to MSMEs participation and internalization of pro-business principles.

Finally, there should be strengthening of the protection of intellectual property of MSMEs. Business (tech) start-up in particular needs strong protection to safeguard their creations and encourage future innovations. The AfCFTA protocol on intellectual property should robustly incorporate this consideration to spur future entrepreneurship.

Conclusion

MSMEs face diverse barriers to cross-border trade in pre-AfCFTA period. The emergence of AfCFTA should constitute a reawakening for national, regional and continental institutions to change course and strengthen the business activities of MSMEs. This will have important impacts on poverty reduction, the realization of both the sustainable development and overall objectives of AfCFTA.

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