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BRIEFING NOTE No. 160

Sustainability of the SME business ecosystem: The missing links to access finance

March 2023

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Summary

Small and medium-sized enterprises (SMEs) are a driver of growth in the African economy and will play an essential role in making the African Continental Free Trade Area (AfCFTA) a success.

This brief analyses the lack of competitiveness of SMEs in Africa and examines the reasons. It also explores the limitations of financial instruments put in place by donors to support SMEs and suggests ways to create a viable SME business ecosystem that would generate interest from development finance institutions and investors.

Lastly, the brief emphasises the importance of a strong pipeline of viable SMEs for the success of the AfCFTA.

Introduction

African governments and development partners have funded business service infrastructures since the 2000s to encourage foreign and domestic investment. Such infrastructure includes clusters, industrial parks, value chains, special economic zones and innovation organisations like incubators, Tech Labs, and accelerators, basically enterprise support organisations (ESOs). These aim to support the growth of SMEs and start-ups by providing access to regional and international markets and facilitating access to financing from financial institutions.

Despite the funding of business service infrastructures in Africa for two decades, its effectiveness has been mixed. Conferences and events organised by African institutions[1] and development partners have revealed varying results. Although some successful businesses have emerged, they remain isolated and limited to specific sectors. The challenge remains: how can SMEs and start-ups align their products and services to the market, develop a viable business model and grow and scale up?

Improving the viability of SMEs and start-ups would significantly advance their role in regional integration, fulfilling the African Continental Free Trade Area's goal of integrating Africa's economy through the development of global and regional value chains. A deeper understanding of the SME business ecosystem could also inform ongoing development initiatives, such as the Team Europe Invest in Young Business in Africa programme and the European Fund for Sustainable Development Plus (EFSD+).

This brief delves into the key factors affecting the development of a viable SME business ecosystem by exploring its essential building blocks. It emphasises the interrelated characteristics that contribute

to the growth and success of SMEs and start-ups. Furthermore, the brief highlights the limitations of blended finance and financial instruments in providing SMEs and start-ups with access to financing.

1. Limits of the existing business service infrastructure for SMEs and start-ups

1.1 Clusters and value chains: struggling to find their place in economic and social development

Clusters are defined as geographically concentrated manufacturing and service companies operating in the same sector, having interdependent buyer-supplier relationships and linkages with the local environment for value creation and employment. Companies belonging to a cluster may share facilities, IT systems and management services to reduce their costs. For example, they may group together to negotiate transport and export rates by sea or air among other co-location and sharing options. In doing so, clusters reduce costs across the value chain, including production through to the enhanced access to markets.

The interactions between firms also foster the exchange of experience and learning thus facilitating the transfer of know-how and co-creation of innovations. The participation of, and coordination between government agencies, business and sector professionals, and service providers (e.g. training centres, laboratory of assay and quality control, the Bureau of Standards) is key to the development and sustainability of such clusters.

Since 2000, Africa has seen the emergence of several clusters, mainly in the clothing manufacturing and leather product industries, in countries such as Ethiopia, Madagascar, Kenya and South Africa.

While these clusters offer a positive environment for small and medium enterprises as well as start-ups, there are still challenges due to a lack of inter-business relationships, leading to a fragmented work environment.

Furthermore, most clusters adopt a short-term market strategy with no formal contracts and a reactive approach to market demand. This is compounded by investors who have a short-term focus on return on investment, leading to unsustainable practices. For example, flower farmers in Kenya have moved to Ethiopia where labour and tax incentives are more favourable. The resulting capital drain results in a disruption of cluster goals or competition from other clusters with different tax or labour systems. This could be a factor in the high rate of cluster failures, particularly in highly competitive industries such as textiles and leather, and to a lesser extent, agriculture and agri-business.

Some of the continent's industries integrated into global value chains (GVCs) are making relative progress. This is the case with automotive components and light engineering (Algeria, Ghana, Morocco, Nigeria, South Africa). It is less true for those industries from the commodity sector. Indeed, the role of many countries is limited at the lower end as producers and exporters of primary commodities (coffee, tea, cocoa, mining products) and importers of inputs or consumers of technologies. In some other cases, countries have entered the processing segment, but activities remain confined to primary processing, where value addition tends to be low, thus generating the least income. Equally worrying, climate change increases the risks to productivity due to weather-related production losses and a lack of stable energy supply (load shedding).

Within the GVCs, powerful lead firms, usually multinational companies, take major decisions around logistics, control activities that entail most of the value added, and pass costs associated with quality standards and pricing to the majority but dispersed producers in the continent. The international distribution network generates mostly benefits for multinational corporations as they, in many cases, control these activities to rationalise costs. In most cases, the working conditions and the living standard of the producers remain precarious, without decent jobs, and countries are also exposed to tax leakages.

The development of the regional value chains (RVCs) in turn could provide the potential to create more jobs by generating backward and forward linkages - including with/through SMEs - and thus add more value, as the wider African market opens up through the implementation of the AfCFTA. However, RVC development remains very limited in the continent with substantial challenges due to the high transaction costs given weak logistic networks in the regions (roads, railways, air, and maritime) and the issue of non-tariff barriers.

1.2 Industrial parks and special economic zones (SEZs): Limited linkages and impact on the local economy

The boundary between industrial parks and SEZs is becoming less and less clear. In both cases, government intervention is central to the promotion of industrial activities, their area is geographically delimited, both benefit from land concession, special development, infrastructure and communication facilities and administrative simplification, both support economic diversification and generate revenue, both are integrated into the export market and mobilise

external investors (FDI). While SEZs benefit from a favourable tax and non-tax regime, industrial parks are increasingly granted these advantages. So how can the two entities be distinguished? They differ at two levels:

- Industrial Parks have specific governance structures, regulations and procedures insofar as they are aimed at the local and export market, while those of SEZs are defined for the exclusive response of the export market, have a separate customs area and may have foreign exchange earnings.
- Industrial parks have linkages to the universities, research centres and innovation hubs ecosystem. In addition to the manufacturing and services sector, they integrate the high-tech sector. In this sense, industrial parks can play a driving role in the development of smart cities in Africa.

But as further explained below, industrial parks and SEZs are often confined, with limited linkages with the rest of the economy, limiting their potential economic contribution. Industrial parks have been established and actively operating in 47 African countries[2]. They host national and foreign businesses in manufacturing (textile, leather, light engineering), agro-industry, logistics (transportation and storage facilities), distribution and services. The incentive for industrial parks is the infrastructure provided to the companies and to the local host and the employment opportunities that they offer. Most of them are strategically located to ease the process of doing business.

For example, they can be established near a seaport or airport and have road and railway infrastructure well developed. The companies benefit from improved services such as reliable energy, utilities, ICT and other facilities. The majority of industrial parks offer tax

incentives that can be extended for up to ten years in some cases. Like clusters, industrial parks work in silos with minimum business relationships beyond the park or between them. This isolation limits their impact, innovation capacity and the economic development of the host country[3].

If a strategic policy was developed to lay down legal structures to allow the backward and forward linkages between the industrial parks with the local SMEs, this would build a sustainable business case, enhance the ecosystem and add value to the economy. This would in turn be linked to the development and strengthening of local SMEs, which accelerate a two-way process of integrating the industrial parks into the local economy and the SMEs to the international markets and value chains by becoming suppliers to (exporting) firms in these parks. Some of the actions in the short term can be achieved via subcontracting, outsourcing or developing simple franchise models that allow sub-ownership of a business model to support the growth and scale of the enterprise.

According to UNCTAD, there are 237 SEZs established by law in Africa, of which half of them are operational and the rest are under construction or at a design level. East Africa hosts 50%, West Africa 24% and North Africa 10%.[4] Most of them provide fiscal incentives, special customs regime, preferential land use and infrastructure facilities. Some SEZs have already established linkages between large companies and local SMEs through outsourcing and subcontracting activities thus extending their market.

This is the case of the East London Industrial Development Zone in South Africa which attributed 6% of contracts to local SMEs and the COEGA SEZ located near Port Elizabeth which grants 35 % of its

procurement to SMEs[5]. In addition, the COEGA SEZ adopted an integrated approach including capacity building of SMEs to improve their performances, thus making them eligible for bidding and financing support to those awarded contracts within the zone. The linkage model developed by these SEZs has contributed to the creation of market opportunities for local SMEs.

But this model would not have been possible without the partnership and strong commitment from the SEZ management, the local authorities and the SMEs professional organisations and investment promotion agencies (IPAs). This partnership (ecosystem) has motivated large companies to integrate local SMEs into their activities. Despite some interesting examples of SME integration in SEZs, most of them remain confined to their geographical area and their linkages with the local economy remain weak.

Therefore, more effort is needed to develop and create a platform for disseminating know-how, new technologies, innovative solutions and methods in manufacturing, services, storage and distribution outside their scope area to reach more local companies.

1.3 Innovation organisations (IOs): An increasingly prominent role

The 2010s were marked by the birth of an ecosystem of start-ups strongly supported by the IOs, including incubators, tech labs, universities-innovation hubs and accelerators. AfricaLabs, Impact Hub, Jokkolabs, African Agribusiness Incubators Network (AAIN) and Meltwater Entrepreneurial School of Technology (MEST-Africa) that have regional and/or continental reach have actively participated in the creation of this ecosystem.

They have focused on women and youth entrepreneurship development in ICT, education, agri-business, energy and finance sectors (FinTech, EdTech etc), promoting knowledge sharing within the start-ups' ecosystem. IO provides facilities that have different functions depending on the technical capabilities and resources. For example, they offer co-working space to their members and services focused on capacity building and mentorship to improve business models.

They provide support towards accessing funding and markets and offer the opportunity to their members to participate in regional and international events to keep them updated with technology trends and to connect them with innovators, corporates, investors, academia, developmental agencies, and advisory services that help them to develop business plans and implement their projects. These organisations also play an active role in the advocacy for better-designed and enabling policies. This is critical in the growth of start-ups and innovation across Africa.

The majority of the IOs have benefited directly or indirectly from international and bilateral development agencies, development finance institutions, venture capital funds, business angel networks and foundations. This has facilitated the creation of an integrated ecosystem that includes start-ups, universities, research centres and business development organisations.

Despite the nascent state, this ecosystem is growing and represents a promising model that offers lessons that can be duplicated to inform the emergence of a robust SME business ecosystem. However, start-ups, as long as they are involved in innovative solutions, have the possibility of finding a framework for their growth and

development, but they could face crucial challenges when moving to a competitive market or environment and in this case, the question is who is ready to handhold them in their growth and exit stage.

2. BLENDING FINANCE: IS IT APPROPRIATE FOR SMEs AND START-UPs FINANCING?

2.1 European fund for sustainable development: Pooling resources

During the past decade, international and bilateral development agencies and development finance institutions (DFIs) have increasingly worked together to address the SMEs financing gap. As a result, an alliance was formed leading to blending resources of development partners such as EC, with financial instruments from multilateral (AfDB, European Investment Bank, International Finance Corporation) and bilateral development finance institutions (EDFI)[6].

One of the most notable examples is the European Fund for Sustainable Development (EFSD) set-up by the European Commission in the framework of the External European Investment Plan (EIP). Established in 2017, the EFSD was designed to provide guarantees and blended finance to facilitate investment (often through financial intermediaries) in the European Neighbourhood and in Sub-Saharan countries, fostering access to finance to entrepreneurs which often face high interest rates or financial requirements (in the form of collaterals).

The fund is dedicated to financing public and private investments through intermediary finance organisations. In addition to the investment fund, EFSD includes a Technical Assistance (TA) fund aiming to identify investment projects to be promoted to potential international partners and to support companies in developing

viable investment projects for financing. The TA fund also includes public and private dialogue platforms[7] to help improve the business environment and investment climate and actions for supporting government reforms leading to the reduction of barriers to investment.

The EFSD had a budget of €5.1 billion for 2017-2021 (€1,55 billion for guarantees and €3.5 billion for blended finance) and is expected to leverage €50 billion of investments.[8] For 2021-2027, the EFSD+ will leverage approximately €40 billion for guarantee and €1 to €2 billion per year for blending finance[9]. The sectors supported are energy, transport, digital, SME financing, sustainable agriculture, biodiversity, forest, water, sustainable cities, human development and sustainable finance.

In the same vein, an initiative from a consortium of EDFIs (DEG, Germany, NORFUND, Norway and PROPARCO, France) lend recently (October 2021) a $60 million senior loan to Ecobank to support its 33 subsidiaries in Africa in the framework of SMEs recovery from the negative impact of the COVID-19 pandemic [10]. At this stage, it is important to know to what extent the blending finance initiatives put in place five years ago had a leveraging effect on SME financing.

Other challenges include the absorption of such an important budget in a context where DFIs and financial intermediaries face difficulties to identify a pipeline of viable projects (with a sufficient ticket size), not to mention the fact that most of them are unaware of the existing blending finance facilities and the operational model and when aware, the complexity of accessing the instruments becomes a barrier to companies at expansion phase.

2.2 Despite available blending financing instruments, start-ups and SMEs are struggling to take off

Many SMEs that have been in business for many years still face challenges in growing due to poor management and the absence of a well-defined strategy for positioning the company in a niche market. Start-ups and SMEs lack equity, sufficient working capital, cash reserves for low activity periods and long-term funding to invest in new technologies. This affects the operations and distribution of their products adversely, and to a large extent, this explains why many entrepreneurs are worried about the survival of their businesses or are forced to close.

Many SMEs respond to a one-time client demand according to their available funding and not on a continuous basis to respond to a larger market which does not allow their activities to be sustained. The stark reality is that most start-ups struggle to take off and SMEs which operate for 10 years are stagnating in the expansion phase and fail to reach the growth stage. Only a few that are integrated into one of the global value chains (or high-value growth sectors) have sustained and expanded their market and reached the maturity stage.

Despite many available credit lines and guarantee funds, SMEs still face difficulties to access them not only due to the high interest rates but also because many are lacking track records on their activities allowing them to prepare the loan application to the standard of a 'bankable project', not to mention that the accounts and financial projections and data are often deficient and not audited. This situation complicates the evaluation of the SME request for a loan which consequently pegs them as high risk.

Aware of their weaknesses, SMEs adopt a resigned attitude towards banks, believing they do not have suitable financial products for their business. The risk factor, which has been mentioned for decades, remains an almost insurmountable barrier for SMEs to access financing. Beyond the risks that these enterprises present for financiers, the absence of historical business data and statistics on the potential applicants becomes a barrier between them and traditional banks. Increasing funding budgets to support start-ups and SMEs is, of course, more than necessary but doing so without tackling the question of why financial intermediaries supported by DFIs cannot find viable companies which could meet the procedural requirements for granting a loan would lead to treading on water.

And if we fail to address the recurring problem of start-ups and SMEs financing in Africa, we risk increasing their frustration and limit the potential impact of blended finance and guarantees which are amongst the tools mostly used by financial institutions for development. In turn, the lack of impact would result in a compromised Africa-EU cooperation and push the African private sector to explore alternative solutions and actors.

3. How to boost start-up and SME growth to generate sound pipelines of projects for DFIs

3.1 SME business ecosystem: What is it about?

The SME business ecosystem is a network where public and private organisations provide economic, technological, and financing solutions for their growth. This will intensify the linkages among large companies and SMEs and will facilitate partnerships and collaborations to achieve higher levels of efficiency and/or to

overcome common problems (e.g. grouping the purchase of inputs or penetrating new markets).

In a robust business ecosystem, the actors and SMEs can build a culture of trust and collaboration and interact successfully. This allows a fast flow of talent, information, and resources. Entrepreneurs can quickly find what they need at each stage of their growth. Successful and supportive SME business ecosystems are those that support enterprises, scaleups, entrepreneurship to leverage operational and technical resources, networks for the exchange of ideas, investors and access to critical assets (especially intellectual, physical, and financial) to create value, improve productivity and competitiveness, generate income, employment, or well-being.

The SME business ecosystem must strongly involve public and private organisations, government and parastatal agencies mandated to boost investment from different economic sectors. These organisations need to establish cooperative, interdependent, and competitive relationships for the sole purpose of ensuring the growth of the ecosystem. The driving force is the innovations in products and services to ensure constant adaptation to the market and that ensures the sustainability of the ecosystem.

Indeed, company leaders in innovation are pulling others up, and large companies are accelerating the subcontracting-outsourcing of activities to SMEs. Sectors to focus on are manufacturing, agribusiness, education, healthcare, ICT, renewable energy, recycling, sanitation facilities, logistics and transport, tourism, infrastructure installations, maintenance of equipment and after-sales service. The SME business ecosystem must be national and regional market driven and could be regarded as an intermediate step in the

framework of larger initiatives aimed at reinforcing clusters and value chains with an international market focus. To this end, the SMEs will benefit from the existing information system related to trade at regional and continental levels.[11]

While we have made relatively good progress since the inception of the AfCFTA in defining the instruments, procedures and rules governing trade on the continent, there is still a huge effort needed to design an architecture that will allow for the emergence and growth of an efficient and effective SME business ecosystem.

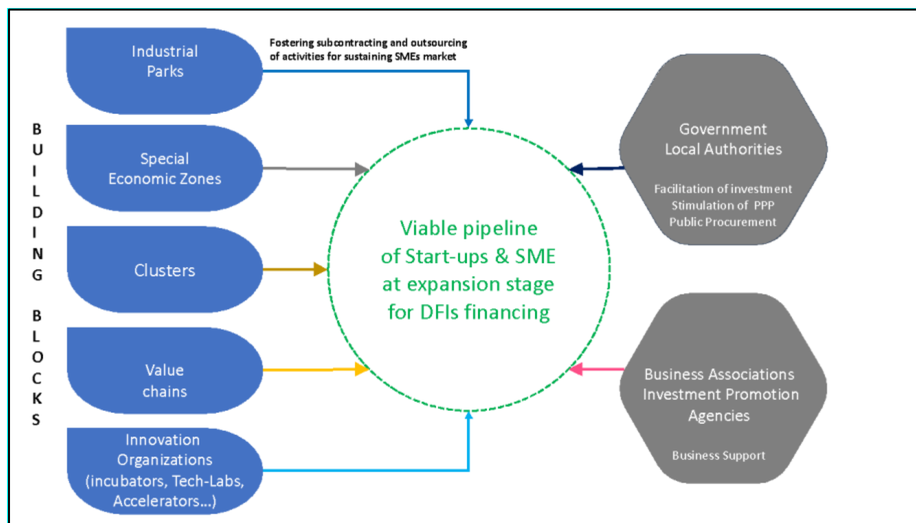
Clusters, value chains, IOs, industrial parks and SEZs can be seen as a reservoir, drivers, and catalysts for SME growth and development and, therefore, contribute to the creation of a viable ecosystem for SMEs. However, SME development through subcontracting and outsourcing has not been prioritised even though it has been encouraged by governments and regional economic communities (RECs). With a few exceptions[12], this route has not been sufficiently well exploited, at best it concerns the construction and public works sector.

Yet, the economic growth of developed countries has been driven by the subcontracting model, which is a contractual operation whereby a large company delegates to an SME part of a public or private market or a production with technical specifications, deadlines, and a negotiated price, while retaining responsibility for the market or finished product. In this case, large companies decide to use subcontracting to benefit from cheaper labour when they plan to respond to a growing market.

As for SMEs, the use of subcontracting is most often motivated by an insufficient financial, technical and organisational capacity to respond in quantity and quality to a market. It can also be motivated by a strategy of specialisation in a segment of the value chain. The obvious advantage of the SME subcontractor is better control of quality, costs and manufacturing times thanks to the transfer of skills and innovations from the partner company to respond to a growing market. In addition, the SME can concentrate on medium and long-term projects in partnership with a large company, which guarantees a constant income and the possibility of investing for growth. In the same vein, the outsourcing model whereby a company entrusts a part of its function to a third party on a permanent basis, with the aim of reducing costs, is limited to accounting, IT and website development, advertising, and legal services while great opportunities exist in production, warehousing, transport, and logistics.

For these reasons, **subcontracting and outsourcing** across all sectors (and not limited to construction and public works) must become the **key priority for building a viable SME ecosystem**.

Figure 1. Start-ups and SME business ecosystem: An integrated approach



Source: Authors

To this end, the role of government, parastatal agencies and the RECs needs to become central. By central, we mean to take the leadership of the initiatives for accelerating the reforms for facilitating the business environment and attracting investment. Indeed, even if these institutions are fully involved in the design of donor programmes addressing these challenges, they were not fully committed during their implementation phase.

Therefore, many private sector development programmes launched in the 2000s and financed by international and bilateral development agencies have not had the expected impacts. In most cases, the sustainability, and the dissemination of the best practices of these programmes are not assured. One of the reasons has been the public authorities failing to take the leadership, letting consultancy groups take full control and execute the programmes on their behalf and the development agencies.

3.2 Public and private partnership (PPP): A growth opportunity for SMEs

PPPs offer an interesting framework for the development of an SME ecosystem. In general, PPP concerns large projects in energy, transportation, public works (roads, bridges), communication, water, sectors, and services (ICT, Health etc) and municipality services (maintenance of street furniture and city gardens, cleaning of urban areas, forest protection and maintenance). Due to the large investment required from PPP projects, the great number of actors involved (several specialised ministries, finance institutions, and private companies) and due critical issues related to regulations, standardisation and safety, PPP projects are very complex in their design, financial arrangements and implementation.

However, opportunities exist for integrating SMEs in PPP on maintenance services. This is true in the road, electricity, communication transmission and sanitation sectors where large companies are responsible for the design and construction while SMEs relay the maintenance of the networks. It also concerns the maintenance of all municipality's equipment and infrastructure. However, beyond the development of a PPP policy, there is a crucial need to develop legislation for integrating SMEs, establishing comprehensive guidelines, and designing tools for empowering enterprises. The support must be dedicated to increasing the capacity of SMEs to understand the public procurement processes and procedures, establishing costing, elaborating work plan, preparing a tender dossier (design of technical and financial offer), understanding the required standards and quality of the services to deliver, the establishment of quality control and monitoring of the networks. There is still a long way to go to achieve this. It is dependent on the political will of the leadership.

3.3 Public procurement: Sustaining SMEs market

Public procurement provides opportunities for SMEs to expand their market, to scale-up and grow through new investments. However, the challenge is not a deliberate allocation of quotas of the procurement to SMEs, many countries are doing it with variable success, but the lack of guidelines, and tools, including good practices for SMEs for accessing public markets.

In summary, the issue clearly comes down to the empowerment of SMEs. Consequently, skills development needs to be at the centre of a strategy for integrating SMEs in public procurement (understanding the procurement processes and procedures (guidelines), including e-procurement ones, how to build a tender dossier with a competitive technical and financial offer, how to negotiate contracts, how to plan and organise the work for meeting the required quality and deadlines, how to respect environmental protection, safety and working conditions of employees).

Improving the capacity of SMEs is therefore essential in public procurement. But more than that, governments need to play a more active role, by creating a pool of viable SMEs recognised for their expertise on specific products and services and by establishing standardised, simplified, and transparent procurement processes, using e-procurement systems.

4. SME business ecosystem: Priorities

4.1 Type of start-ups and SMEs to boost in the business ecosystem?

The selection of SMEs according to their size (level of investment, number of employees, turnover) is not relevant given the country-

specific classifications, but also because it is hardly possible to see at what stage the company is in its development and the steps it needs to grow. We, therefore, adopt a more qualitative approach, considering the company's current situation, its ambitions to grow and its readiness to network with other companies in the ecosystem. These companies use good practices to produce competitive products or services according to current standards and adopt environmentally friendly processes through modern management methods and green technologies leading to a better ecological balance sheet.

We, therefore, retain four categories of companies that can constitute the network of a viable business ecosystem, and which are at different levels of financing needs.

- Start-ups at an early stage

In this stage, the company has defined the product (prototype), and completed the market analysis and business plan. The company starts to showcase the product to potential investors and begins aggressive go-to-market activities. This phase requires, in some cases, to market fit the product, conduct additional research and mobilise additional staff. The financing needs are usually in the €50 to 100 000 range. Business angels, crowdfunding, foundations, and some early-stage venture capital funds intervene in this phase.

- Start-ups and SMEs at the expansion stage

This stage is considered an emerging phase for the company. New capital is dedicated to transforming commercialisation of products or services and putting more effort into marketing. During this phase, the company starts to generate revenue. The funding needs (on average €100 000 to €500 000) will be dedicated to optimising production and scaling the product into the markets. The issue is that

many companies fail to get a bank loan at this stage and if they do, they find it difficult to repay the loan or worse, some become bankrupt.

- SMEs growth stage

The activities of a company are progressing rapidly at this stage requesting more funding for further expansion and to access more markets (regional or international), finance needs come at an average of €500 000 to €2 million. It is in this phase that SMEs can integrate bank loans as a viable means of financing their business.

- SMEs maturity stage

The investors inject funding to enable the scaling of the company thereby realising a high return on investment. The level of financing averages €2 to 5 million.

Above €5 million financing needs, the SME can be considered as joining the circle of large companies active in the ecosystem and ready for commercial loans, concessions or listing through initial public offers (IPO).

Based on this classification, what kind of financing instruments are appropriate for enabling start-ups and SMEs at expansion stage (the most critical one) to grow within a defined business ecosystem? Beyond the blending finance instruments we mentioned, and which could be used for guarantees, there are other options to be considered which can be a greater value for start-ups and SMEs.

4.2 Challenge Funds: Towards an extension to the five building blocks

While companies at the growth and maturity stage can use traditional financing instruments (loan, equity), those at expansion

stages will have serious difficulties accessing sufficient funds. To cope with this situation, challenge funds have emerged in recent years mainly to support micro enterprises in the agricultural sector, which is one of the riskiest[13]. The challenge fund model, which combines additional cash in the form of a grant with patient capital, deserves attention.

Patient capital funding differs from traditional private equity or venture capital firms. It is defined as an investment generating positive impact at social and environmental levels by building sustainable business enterprises and long-term growth rather than short-term financial return as in venture capital funds and tolerates higher risks compared to the traditional banking system. Patient capital is often provided to companies and organisations concentrating their activities on agriculture and agri-business, healthcare, water, and energy.

A grant scheme combined with patient capital helps SMEs exploit, develop and sustain a market and therefore it is adapted to the needs of start-ups and SMEs at the expansion phase. It can be used to scale enterprises with financing needs of €50 000 to €500 000. A focus of development partners and DFIs on the creation and multiplication of a challenge fund model tailored to this category of enterprises active in the leading sectors (see figure 2) and targeting the five building blocks of the SME business ecosystem can contribute to decreasing the financial stress of SMEs and start-ups and the risk of failure in their early stages.

The stability created by this model will allow the entrepreneurs to concentrate on the key actions (strengthening their management, know-how for bidding and procurement, elaboration of marketing

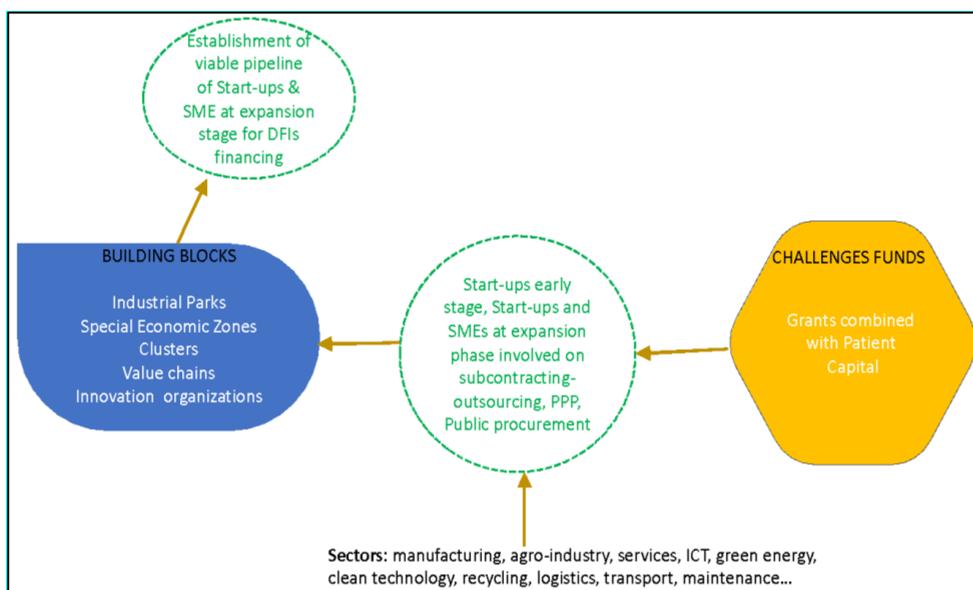
and distribution strategies) and, in consequence, to consolidate and sustain their activities.

This challenge fund model will focus on:

- Start-ups through the provision of patient capital and a non-refundable grant to women and young entrepreneurs with innovative projects and who generally have difficulties accessing finance during the first three years.
- SMEs at their expansion stage through patient capital and the provision of partly refundable grants[14] for financing new investments and accessing new markets.

It will benefit enterprises which demonstrate that their investment will have a social impact (improvement of life of the rural or urban population, involvement of the community), will generate employment, ensure environmental protection (use of green energy, clean technology recycling) and respect rights and working conditions of employees. This is most likely SMEs involved in subcontracting and outsourcing, PPP and public procurement activities. However, once the companies reach a level of growth, they will be oriented towards equity and loan formulas provided by financial institutions.

Figure 2: Establishment of start-ups and SMEs business ecosystem: Process



Source: Authors

Given the kind of start-ups and SMEs to target based on their stage of development, social impact as well as links to the building blocks mentioned above, DFIs and development partners can thus focus their efforts on the mentioned category of companies. In this context, DFIs and development partners should put in place instruments better adapted to this category of enterprises. This can take the form of stronger partnerships between the financial intermediaries supported by DFIs and development partners (development banks, venture capital funds, business angels) and the existing challenge funds that have expertise in combining grant schemes and patient capital.

This is one of the ways to reach the largest number of this category of organisations and allow them to evolve without financial stress and to progress in their growth. While what is being proposed here is not new, the support of challenge funds currently remains targeted

to mainly micro-businesses in the agricultural sector and their operations are still protocol heavy and complex.

Dr Ebiekure Jasper Eradiri, Secretary General of All Africa Association for Small and Medium Enterprises (AAASME)[15] endorses the proposed Challenge Fund model. However, with reservations on the current approach to the blending finance model, he posits "that a home-grown blended finance solution which serves as an alternative recipe for easy access to finance has become imperative for the Continent's SMEs. AAASME shall continue to champion the cause and hold hands with like minds to achieve the desired Afrocentric Model or at least a hybrid model approach integrating components that reflect the realities of true inclusion for the benefit of SMEs and also gradually assist in the process of reviewing the western legacy finance model template which is not contemporary enough to address the peculiarities of Africa's SME ecosystem thereby constituting barriers to economic growth, prosperity as enshrined in Agenda 2063 document for the 'Africa We Want".

The message is loud and clear. It is about redesigning the current architecture of SME financing to better consider their specificity and needs at each stage of their development and consequently stimulate investment and trade. But more broadly, regional, and continental policies that favour a gradual approach to the growth and development of a sustainable SME business ecosystem are more likely to succeed. Indeed, before jumping into international trade, African SMEs must build a base that first feeds and trades within, to the neighbour, in a region, inter-regional then continental.

The AfCFTA provides significant potential in this regard. When the base of Africa trading with herself is completed, then, we can find

ways of exploring those other markets beyond. This is the model that will first heal the perennial problems leading to the success of the continent's economic growth and integration. However, in order to leverage the opportunities that the AfCFTA provides, start-ups and SMEs need to be capacitated and prepared, a major part of which includes financing.

Business success takes many pillars working in unison; however, business opportunities must first be founded on the needs of the local ecosystem and then organically grow to capture value in other ecosystems. This is where investments must be directed if the triple bottom line of economy, sustainability and society are to be achieved. With this as a key area of focus, development partners and DFIs can play a major role in ensuring the success of the AfCFTA.

Endnotes

1. 7th EU-Africa Business Forum-14-18 February 2022; Africa Union First SME Forum-Cairo, Egypt, 27 June, 1 July 2022.
2. Insight Agility logistics park – June 2021.
3. This is particularly true for Ethiopia Industrial Parks.
4. Handbook on Special Economic Zones in Africa. Towards Economic Diversification across the Continent, UNCTAD, Africa Union, GiZ, 2021.
5. Same reference as above.
6. BIO (Belgium), British International Investment (UK), Development Bank of Austria, DEG and KfW (Germany), FinFund (Finland), FMO (Netherland) IFU (Denmark) Nordfund (Norway), PROPARCO (France), SIMEST (Italy), SIFEM (Switzerland, SOFIDES (Spain), SOFID (Portugal), Swedfund (Sweden).
7. The Sustainable Business for Africa (SB4A), EU- Africa Business Forums.

8. New EFSD+ and the EIB's External Lending Mandate, EC - DG for Internal Policy, Communication to the EU Parliament, February 2022.

9. EC-European Fund for Sustainable Development (EFDS +). Communication, M. Philippo Gabriele La Verghetta. February 2022.

10. Private sector development 37. PROPARCO magazine. Second quarter 2022 (in collaboration with EDFI members).

11. Electronic Single Window established by customs authorities.

12. Algeria, Egypt, Ethiopia, Kenya, Morocco, Nigeria, Ghana, South Africa.

13. Africa Enterprise Challenge Fund, Agrifi Kenya Challenge Fund funded by EC, EIB and Slovak Aid, Zambia Enterprise Challenge Fund (financed by EC), Malawi Innovation Challenge Fund supported by KfW, UNDP; International Fund for Agricultural Development (IFAD); UK Aid.

14. The grant can be used to cover 50% of the eligible costs such as construction, equipment and the acquisition of licences/software that are necessary for implementing their activities.

15. AAASME is a Continental body promoting, supporting and protecting the interests of SMEs as well as a leading Advocacy voice for the Afro-Centric Model of Finance for Africa's SME Ecosystem.