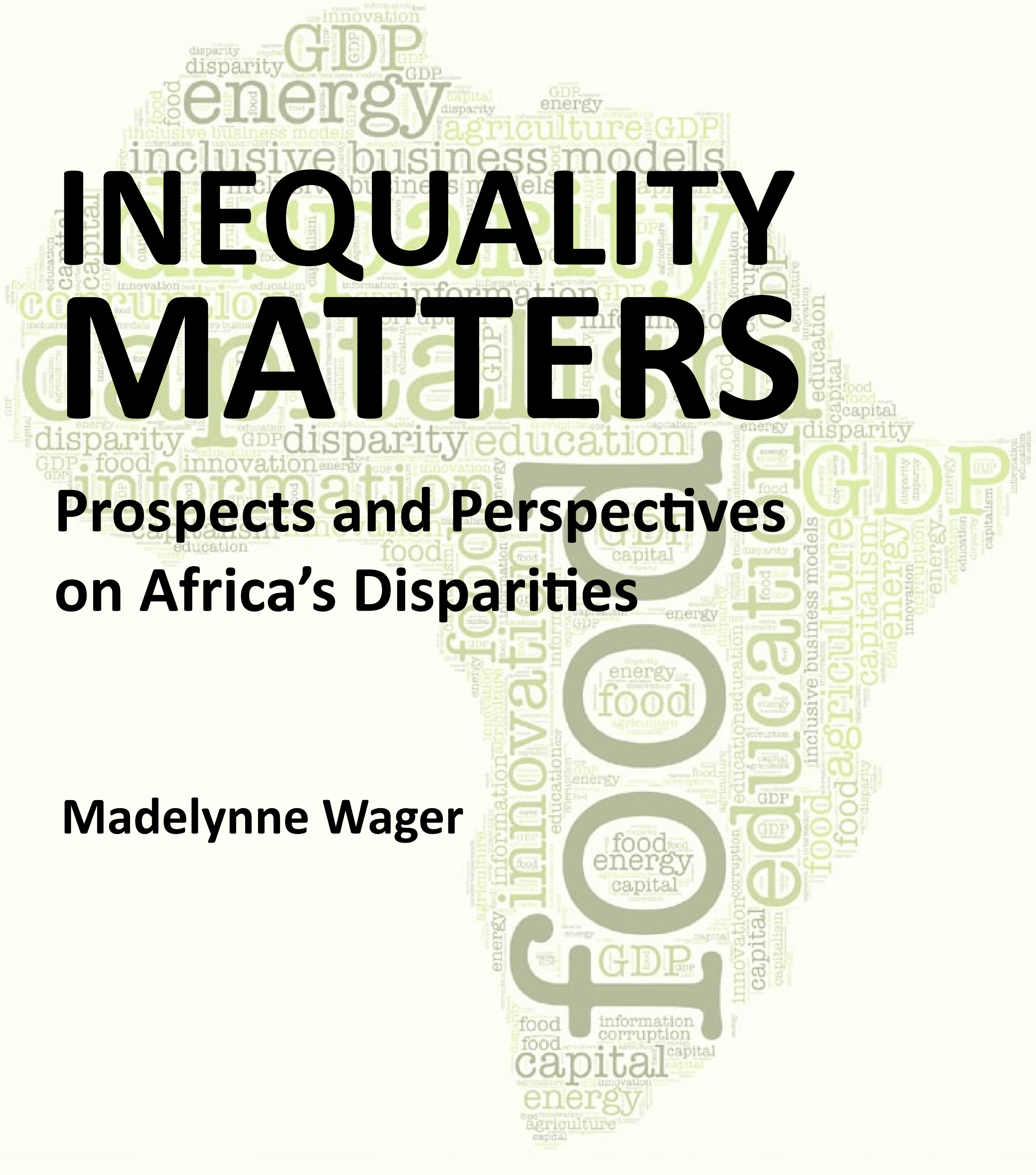
DISCUSSION PAPER 4/2013

INEQUALITY MATTERS

Prospects and Perspectives on Africa’s Disparities

Madelynne Wager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innovation
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Strengthening Africa’s economic performance

THE BRENTHURST FOUNDATION

INEQUALITY MATTERS

Prospects and Perspectives on Africa's Disparities

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Executive Summary

The destabilising effects of inequality are manifest across Africa. Workers and impoverished communities are growing more frustrated with their economic exclusion. Africa is the world's most rapidly growing continent. But evident increases in GDP are largely a result of expansion in commodity sectors which create little direct or indirect employment. A large portion of Africans never see the benefits of their nations' seemingly impressive growth.

The level of inequality in a society matters. Inequality does not only create instability and sour investment, but scholars and policymakers have turned their attention to studying disparities as a determinant of social and economic problems. Numerous studies demonstrate strong correlations between inequality, slowed economic growth and poverty reduction. While the topic is still marginally contested and measures of inequality can be inaccurate or blurred, inequality clearly operates through a variety of channels to slow growth and impede poverty reduction.

Fortunately, as outlined in this Paper, a diverse set of businesses have recognised their role in addressing African disparities. Multinational companies and African entrepreneurs are designing business models that incorporate low-income markets into the core activities of the firm, creating employees, consumers and producers in previously excluded markets. Beyond improving the health of the market system, these firms realise significant financial rewards and access new areas of long-term growth. Inclusive business models hold promising potential to sustainably fulfil unmet needs and act as a solution to unshared growth.

However, even the most innovative entrepreneurs and managers with inclusive business models face challenges when doing business in Africa. Their operations are met with poor infrastructure, limited market information, insufficient support systems and financing constraints. Governments can help address these challenges by creating conducive policy environments and adopting specific technologies to meet the needs of businesspeople, extending significant improvements in economic opportunities to their people.

The success of economic development depends on the ability to include all people in growth. African private and public sector actors must collaborate to realise more inclusive development.

Introduction

Seemingly ignored by the world of commerce and victimised by corruption, African workers are striking out against both public and private institutions. The continent's growing inequality and instability threaten governance and secure market conditions. Accordingly, the public and private sectors face an imperative to collaborate. Government policies set the framework for addressing disparities, but private firms ultimately mobilise the capital and resources necessary for generating the employment and wealth that make tangible improvements to quality of life. By creating an environment in which businesses incorporating low-income markets – or inclusive businesses – can thrive, the public and private actors can create more sustainable solutions to inequality and related development challenges.

> Private firms ultimately mobilise the capital and resources necessary for generating employment and wealth

The level of inequality in a society matters. Traditionally, economists have focused on poverty as the key determinant of social ills. However, in recent years scholars and policy makers have devoted considerable attention to the links between inequality and social and economic problems. Studies demonstrate strong correlations between widening inequality and rising levels of crime, insecurity and instability. And inequality has been shown to slow economic growth and poverty reduction by undermining the creation of a consumer class, skewing nations' political economies and creating capital market imperfections that in turn perpetuate existing disparities, such as levels of education.

Moreover, inequality can undermine the poverty reduction capacity of growth. Growth rates measured by gross domestic product qualify Africa as the fastest growing continent in the last decade. However, these superficially impressive statistics mask increasing disparities. Top African businessmen and entrepreneurs like Tony Elumelu recognise African growth is being driven by sectors that do not contribute to real value addition.[1] Instead, African growth is largely dominated by commodity extraction that provides limited direct and indirect employment and linkages into local firms, and subsequently does little by way of poverty reduction.

Despite the concentration of African growth in commodities, significant financial reward can be gained when businesses aim to incorporate low-income markets into their core activities. African entrepreneurs and Multinationals (MNCs) have recognised the growth potential in low-income markets, and inclusive business models are popping up across the continent. However, insufficient market information, inefficient bureaucracy, financing gaps and inadequate implementation support constrain these businesses from reaching a large scale.

This Paper addresses some of the important conceptual and definitional issues of inequality, outlines some of the financial benefits realised by including low-income markets in business models, and presents the positions of senior decision makers on potential public sector actions to enable African business to propel entrepreneurship as a solution to development challenges and inequality.

Defining Inequality

Inequality is a measure of social disparity. Its consequences may seem intuitively troublesome, but it is multidimensional and difficult to analyse. While income disparities are central to discourses on inequality, differences in wealth distribution, gender inequalities and unequal access to schooling – among others – also significantly impact equity outcomes. Inequality's multifaceted nature makes it difficult to measure and imperfect data further undermines efforts to devise sophisticated empirical perspectives.

Measures of Inequality

Personal income distribution is the most common focal point of inequality concerns; unspecified references to inequality generally describe differences in personal income. These gaps are measured by a number of statistical devices, including the Gini coefficient.[2] Globally, most nations have experienced an increase in the inequality of personal income distribution since the 1980s. However, Africa has had a balance of countries with rising and declining inequality.[3] Still, in 2010, six of the 10 countries with the most unequal income distribution were in sub-Saharan Africa: Namibia, South Africa, Botswana, Angola, the Central African Republic and Zambia.[4] A recent UNDP trade and development report attributes Africa's prevalence of unequal states to the number of natural resource-rich nations in which local elites and international capital have succeeded in capturing the majority of the rents generated by their nations' natural endowments.

Personal income inequality is perhaps most interesting because of its close relationship to poverty as both depend on household income. It seems natural that higher inequality and higher poverty are correlated, but different rates of change in poverty and inequality can produce various outcomes. An increase in real per capita income and a more equitable income distribution are ideal for reducing poverty. But other combinations could have vague consequences. For example, 'per capita GDP and inequality may grow (or fall) at the same time, and lower food prices may pull urban households out of poverty but reduce the earning of low-income peasants'.[5]

Trends in African Inequality

Africa is the second most inequitable region after Latin America.[6] When measured by income shares of the poor, African inequalities are stark and accompanied by geographical disparities between urban and rural areas, where the poor are concentrated. A larger percentage of the population is poor in rural areas (56.9 per cent) than in urban areas (49.6 per cent).[7] And the lowest 20 per cent of Africa's population holds 5.2 per cent of the region's wealth, compared to the 51.5 per cent held by the top 20 per cent.

Income distribution in Africa appears to be characterised by some equity for the middle-income classes, while holding significant differences within rich and poor income groups. Those living on less than US$2 per day account for 60.8 per cent of Africa's population and hold 36.5 per cent of Africa's total income.[8] Those living on more than $20 per day account for 4.8 per cent of the population and hold 18.8 per cent of income. However, the lower-middle class – those living on between $4 and $10 per day – is nearly balanced as they account for 8.7 per cent of the population and hold 9.9 per cent of the income.[9]

South Africa has the highest Gini coefficient among African nations, registering at 0.63 in 2009. Outstandingly high inequality is generally concentrated in Southern Africa. Yet, inequality increased in all of sub-Saharan Africa in the 1980s and 1990s, particularly in Central, East and West Africa. 'In the 2000s, it decreased in Southern Africa and to a lesser extent in West Africa, but showed little change (or increased) in some sub-regions, where the pattern of economic growth reinforced inequalities'.[10] Significantly, Africa has seen falling shares of wage incomes and inadequate generation of productive, formal employment opportunities.

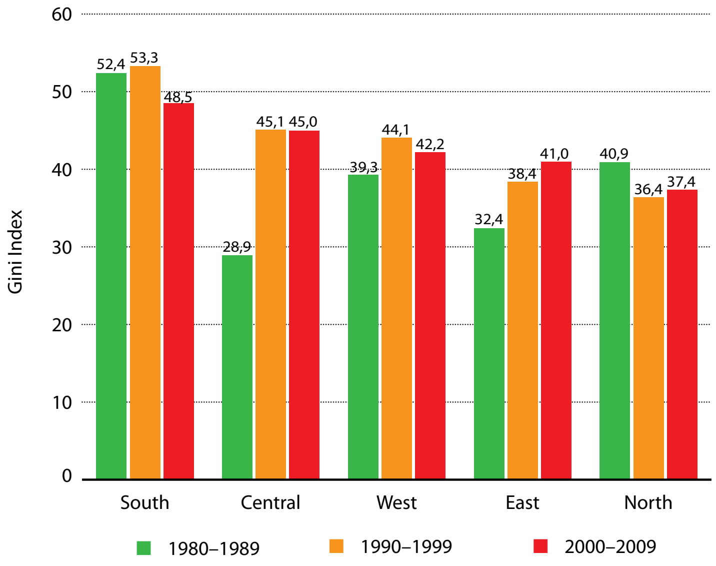
African economic output has more than doubled over the past decade. And while African growth remains largely dominated by commodity sectors, some African economies are beginning to diversify sources of their economic growth, which could imply more inclusive development going forward. The continent is experiencing high growth rates in sectors like consumer products, telecommunications and financial services (see Figure 2). Because these sectors produce more economic linkages than growth in commodities, African growth will become naturally more inclusive if these sectors maintain pace.

African states' various inequality levels arise from distinct, complex circumstances; the nations have different factor endowments, colonial legacies, experiences with independence, democratic maturities, etc. Accordingly, inequality is best understood at the national level, contextualising hazy data within nations' socio-political fabrics.

Marked Elements of African Inequality

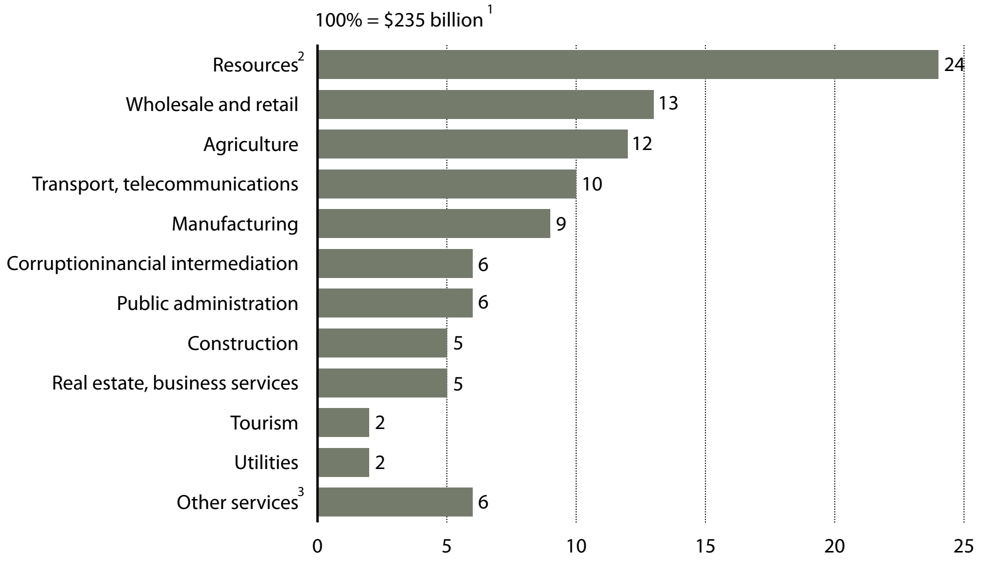
Educational access is one critical, circuitous dimension of African inequality: quality educations lead to enhanced job opportunities and higher income, which can purchase a favourable education, and so on. Access to education in Africa has increased dramatically – enrolment increased from 14.6 per cent of the population in 1971 to 48.8 per cent in

Figure 1: The Gini Index by African Region, 1980–2009



Source: African Development Bank Group, *Briefing Notes for AfBD's Long-Term Strategy: Briefing Note 5*, Inequality in Africa, 7 March 2012.

Figure 2: Sector share of change in real GDP, 2002–2007



[1] In 2005 dollars.

[2] Government spending from resource-generated revenue contributed an additional eight percentage points.

[3] Education, health, household services, and social services.

Source: McKinsey Global Institute analysis

2010.[11] But the quality of that education remains a concern and low income levels remain a major barrier to all levels of educational attainment. African educational inequalities remain the highest of all global regions. But those African countries with the lowest levels of educational inequality also have the lowest levels of overall inequality. Accordingly, high-quality education is widely accepted as a major step for transitioning formal equality into equity.

Gender disparities are another prominent aspect of African inequality. African women in particular face an array of social barriers that keep them from leaving principally subsistence agricultural occupations and entering the formal labour market.[12] Women perform a substantial amount of unpaid work. Hence, traditional measurements of their economic output are misleading. Gender-related income inequality therefore remains one of the most significant forms of African inequality but goes largely unnoticed by statistical measurements.[13]

Former Prime Minister of Mozambique, Luisa Dias Diogo, sees gender as a critical element in questions around inequality, not least because women – who represent 52 per cent of Africa's population – are often effectively excluded from policies, yet they possess a unique set of skills that should be utilised for nations' development. Women's access to formal income is critical because women's work has been shown to multiply productivity gains, as women dedicate more income to food, medicine, education and other family needs than do men.

Concerns regarding urban–rural divides are also particularly relevant as Africa continues to be the most rapidly urbanising continent; African spatial inequality is evident and growing across a number of living standards. Significantly greater inequalities exist in the distribution of education in rural areas than in urban areas, and rural inequalities in health tend to be greater than urban health inequalities. For example, a recent study showed six of the 12 African countries in the sample had an asset index poverty headcount[14] more than 50 percentage points greater in rural areas than in urban areas; the smallest urban–rural divide was in Kenya at 30 percentage points.[15] School enrolment rates in urban areas are also dramatically higher than those in rural areas; Niger had a 55.5 per cent urban enrolment rate and a 14.6 rural enrolment rate.[16]

Inequality Slows Growth

Inequality generally points to a deeper concern: intractable poverty. If the market system generates wealth but fails to distribute those benefits somewhat equitably, the system fails its objective to better the quality of life of all citizens. However, unhealthy levels of inequality do not only indicate the failure of the system to distribute gains; unhealthy inequality constrains the market, slowing growth and the potential to realise additional poverty alleviation. Governments can help ease these effects (see Appendix A) and the private sector can also begin to play a more active, direct role.

Measuring the Inequality–Growth Correlation

Understandably, the empirical evidence used to link inequality and growth must be understood to determine if inequality is in fact troublesome for growth. Recent studies have produced data in two general categories: cross-country data, which studies long-term interactions between inequality and growth; and longitudinal data, which studies the medium-term relationship. Studies using cross-country data show a negative relationship between income distribution and growth.[17]

Longitudinal studies famously include Li and Zou (1998) and Forbes (2000) and use five-year growth periods to show a positive relationship between inequality and growth – indicating inequality is good for growth.[18] However, these studies have at least two major empirical flaws, as distinguished by a recent UNCTAD report. Firstly, these longitudinal models show a correlation between inequality and growth while measuring inequality as it relates to medium- to short- term growth, while most theoretical models indicate a relationship in the long run. Secondly, the linear structure imposed in standard growth regressions may produce biased results as real world relationships are virtually never linear.

> Inequality generally points to a deeper concern: intractable poverty

Analysis of more recently collected data, which is of better quality than previously available, largely demonstrates a negative relationship between inequality and growth. And recent evaluations of inequality–growth literature by respected economists like William Easterly and Nancy Birdsall also conclude inequality is harmful for growth. This relationship has become clearer thanks to the latest developments in household surveys that have improved the quality and quantity of data.[19] For example, the World Development Indicators now provide a relatively homogenous set of data for 142 nations.

However, despite data improvements, employed measurements must still be interpreted cautiously. For instance, Palmer (2011) finds inequality is rather homogeneous among middle-income groups and heterogeneous at the extremes. This raises serious concerns for the accuracy of the Gini coefficient, especially in the African context. The Gini coefficient is designed to be more responsive to changes in the middle of the distribution, where African nations are most equal, implying the Gini could portray African inequality as less extreme than it is in reality.[20]

> Incomplete and heterogeneous statistical measurements of income distribution make the inherent complexities of measuring and understanding inequality even more challenging

The incomplete and heterogeneous statistical measurements of income distribution make the inherent complexities of measuring and understanding inequality even more challenging. Methodological breaks make country comparisons worrisome. For instance, definitions of inequality often differ in developed and developing economies. African and South Asian statistics describe expenditure rather than income; the differences become problematic because concentrations of income are significantly higher than expenditures since savings increase with income. Therefore, cross-country comparisons can be dubious because of their dissimilar measurements. Moreover, statistical inconsistencies impede comprehensive and long-run understandings of inequality.

Mechanisms through which Inequality Slows Growth

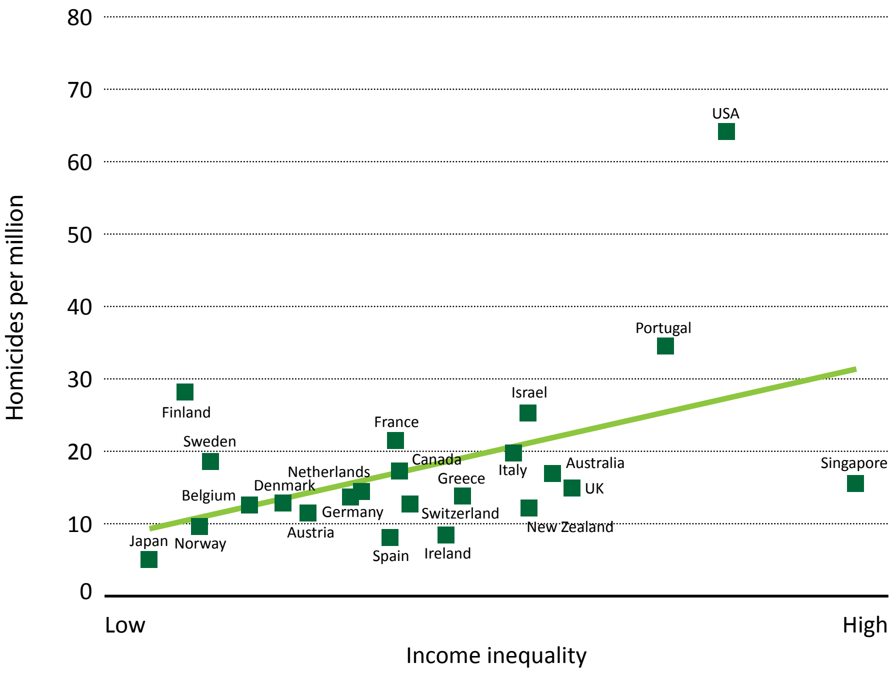
Though difficult to measure, inequality has a generally clear effect through a number of channels. Income inequality can harm growth by undermining the creation of a 'consumer class'. Because businesses make investment and hiring decisions based on their expectations of future demand, high wages and minimal inequality can stimulate economic growth by increasing expected demand. If workers' wages are pushed to minimal levels their ability to purchase products is undermined and businesses have fewer consumers for whom to produce. A rising middle class stimulates demand for manufactured products, the manufacture of which provides most productivity gains. Therefore, reducing income inequality facilitates economic growth via increasing demand for products with growth-enhancing properties.[21]

Capital market imperfections created by high levels of inequality also have a direct negative impact on growth.[22] These capital market imperfections can hamper human capital formation by denying low-income individuals the opportunity to invest in education and attain higher returns on their labour. In addition, if the poor identify potential investment projects with high returns, they are not able to adequately invest in the perceived opportunity due to their restricted endowments and inability to access credit markets because of the imperfections.

> Though difficult to measure, inequality has a generally clear effect through a number of channels

Moreover, inequality may skew nations' political economies. Gross disparities enable elite lobbies to capture further economic rents and fight for national policies that preserve their existing wealth, undercutting effective levels of redistribution and national investments in things like infrastructure and education. The heavy reliance on commodity sectors in Africa makes this concern particularly relevant for the continent. However, alternatively, more unequal societies with stronger democratic systems may experience popular demand for excessive redistributive policies, which could undermine private investment. Consequently, both excessive and inadequate redistribution arising from unbalanced political-economic channels can slow growth.

Figure 3: Homicide rates are higher in more unequal rich countries



Source: Wilkinson & Pickett, *The Spirit Level* (2009)

Finally, a number of experts argue inequality ignites social upheaval.[23] For example, Wilson and Pickett's popular book, *The Spirit Level*, provides data that demonstrate inequality directly correlates with crime levels and other measures of social dysfunction (see Figure 3). Ensuing criminality erodes property rights and creates uncertainty among investors. Subsequently, transaction costs rise and investors turn away from prospects in havoc ridden nations. Therefore, inequality slows growth by instigating social instability and denying new and continued investment opportunities.

A Role for African Businesses in Addressing Inequality

In addressing inequality the question is not whether capitalism or some other system should be mobilised, but rather determining how capitalism should be practiced. Capitalism creates wealth more effectively than any other known system. It allows higher levels of self-governance and unlocks a higher fraction of human potential with organic incentives that reward hard work, ingenuity and innovation.[24] Importantly, the model also adapts to different nations and cultural contexts.

However, critics charge – not without justification – that capitalism today insufficiently regards its societal impacts. Instead, the intense focus on short-termism and an over-reliance on GDP as the primary metric of prosperity has arguably exacerbated the problem of inequality and – crucially – may have weakened the capitalist system itself. Dr. Donald Kaberuka, President of the African Development Bank, argues the collapse of investment giant Lehman Brothers in 2008 marked the beginning of the end of market fundamentalism globally. Subsequently, businesspeople are beginning to see a role for firms in improving the market system. After all, it is the private sector that will ultimately transform policy goals and objectives into tangible activities that impact quality of life.

Fittingly, meeting unmet needs in low-income areas currently excluded from the market system may also present the greatest opportunity for firms to define a compelling trajectory for future growth.[25]

The Business Case for Addressing Inequality

Scholars and business leaders increasingly recognise that firms can *do good by doing well.* And firms are increasingly finding commercially successful ways to engage poor people as consumers, suppliers and distributors. These strategies are now known as 'inclusive business models', and their financial benefits reach far beyond the obvious advantage of accessing massive latent purchasing power.

Pressures to increase price performance in low-income markets and renewed corporate culture will increase firms' operational efficiency

Conditions in low-income markets force firms to place extraordinary emphasis on price performance.[26] Operating in environments with weak transportation, energy and financial infrastructures suggests companies must achieve optimal pricing efficiency in all areas of operations in order to make their products and services affordable for the poorest. The cost-saving lessons learned by operating in low-income markets should influence the management practices of global firms and improve overall cost performance. By forcing MNCs to rethink their assumptions about channels and distribution costs, low-income markets can serve as bursts of creativity for reducing price points across the firm.

Furthermore, by creating a corporate culture focused on creating long-term value, corporations will attract and retain talent, decreasing human capital costs. Young people increasingly want to work for a company with a purpose. If corporations fail to meet the needs of all stakeholders, they may have an inability to attract the most talented employees.[27] This is crucial because human capital is increasingly recognised as the key to competitive success.[28] The 'Best Companies to Work For in America' in January 1998, as listed by *Fortune* magazine, earned average annual returns of 14 per cent by the end of 2005 – over double the market return, suggesting employee satisfaction improves corporate performance.[29]

Implementing innovations from low-income markets into more developed markets creates significant financial reward

Significant financial reward can be realised by expanding innovations conceived in low-income markets. Pioneer of 'base of the pyramid' thinking, C. K Pralhadad, even argues there can be a 10–200 times cost structure advantage associated with innovation among low-income communities compared to traditional innovation amongst high-income populations.[30] Water, energy and transportation are scarce and expensive in low-income markets, forcing superior product design. Thus, innovation that stems from low-income markets is more cost efficient and environmentally sustainable than innovation conceived in developed markets.

> Scholars and business leaders increasingly recognise that firms can *do good by doing well*

For example, detergent soap used by BOP consumers can become mushy when running in water, losing 20–25 per cent of the detergent in the process. Hindustan Lever Limited (HLL) developed soap with a coating that makes it waterproof and saves 20 per cent wastage, even in a hostile environment; the innovation and resultant savings also benefit the rich.[31] Diaper design is another interesting example; the poorest consumers cannot afford to frequently change and dispose diapers. Consequently, companies have been forced to increase the absorbency and improve the construction of their diapers to be sold in lower-income markets. In both the case of the soap and diapers, the result is that firms have technically upgraded the products they sell to the rich. The new product built for the BOP market is better quality and provides a better price-performance proposition.

Corporations will improve their competitive positioning by incorporating social consciousness into business models

By moulding business models in a way that addresses inequalities, corporations create a strategic advantage by strengthening their brand and public trust in the company.[32] According to the 2011 Edelman Trust Barometer report, there are new expectations for corporations that include the 'expectation for companies to act collaboratively to benefit society not just shareholders'. The report explains businesses must 'build an enduring foundation of trust by asking leaders to commit to a strategy that brings value to both investors and society'. Some studies show that by integrating stakeholder perspectives into this strategy, managers will also be 'best placed to optimise stockholder returns over the longer term'.[33]

Firms will reap direct financial benefits by adopting a longer-term perspective and improving their transparency

Firstly, firms that substantively incorporate their societal impact face significantly lower capital constraints through reduced agency costs and informational asymmetries.[34] Because inclusive business models are associated with superior stakeholder management, the likelihood of opportunistic behaviour is reduced and substituted for by more efficient forms of contracting with key constituents.[35] By building stakeholder relationships on mutual trust firms can both reduce potential agency costs by pushing managers to discard short-termism and enhance the revenue potential of the firm, which is rewarded by the markets. [36]

Moreover, as firms become more transparent and accountable by publicly disclosing additional data, perceived risk is mitigated and firms face lower capital constraints and reduce the firm's cost of capital.[37] Importantly, the relaxation of capital constraints allows firms to make strategic investments they might not otherwise be able to pursue.[38]

Additionally, high sustainability[39] companies significantly outperform their counterparts over the long-run in accounting and stockmarket performance. Eccles, Ioannou and Serfeim from Harvard Business School find annual abnormal performance is higher for high sustainability firms compared to low sustainability firms by 4.8 per cent.[40] This effect is even more pronounced for firms that sell products to individuals, compete on the basis of brand and make substantial use of natural resources – indicating the rewards may be particularly impressive in the African context.

High sustainability firms also outperform low sustainability firms on the stock market. An investment of US$1 in early 1993 in a high sustainability firm would have grown to US$22.60 by the end of 2010. In contrast, investing US$1 in a low sustainability company in early 1993 would have grown to only US$15.4 by the end of 2010.[41] Furthermore, when monitored for nearly 20 years, high sustainability portfolios consistently demonstrated lower volatility and experienced higher returns in 11 out of the 18 years.[42]

Notably, by building new markets, strengthening supply chains and their reputations and retaining talent, firms simultaneously meet previously unmet needs, increase income and purchasing power, enhance productivity and instil self-confidence in low-income markets by enlarging the choice sets of these communities.

Inclusive Businesses in Africa

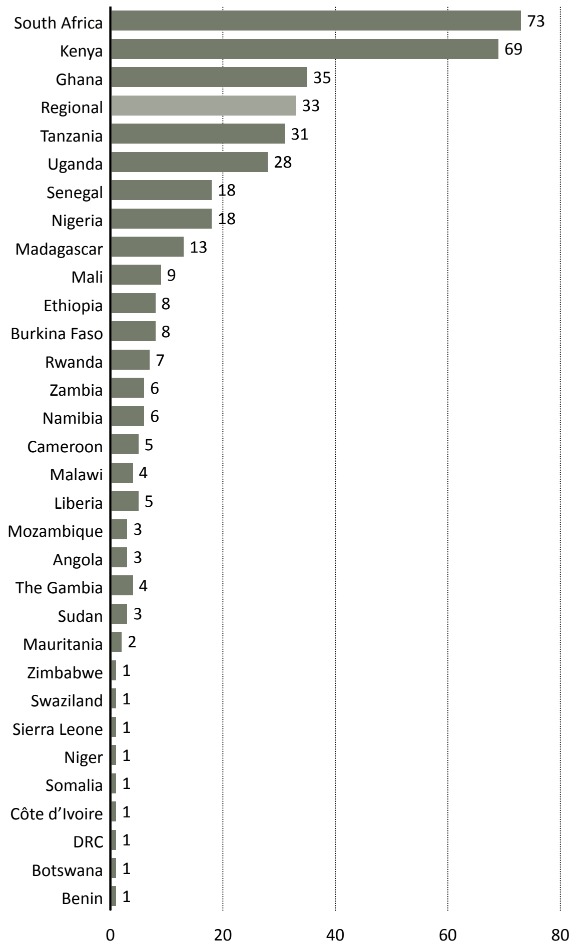
A diverse range of companies have implemented inclusive business initiatives in sub-Saharan Africa. For example, Phillips has translated the company's environmental commitment to product innovation into projects generating energy-efficient light bulbs and solar-power lighting in sub-Saharan Africa. SAB Miller sources ingredients from around 50 000 smallholders in Zambia, Zimbabwe, South Sudan, Uganda, Mozambique and Tanzania.[43] And a recent UNDP report was able to include a survey of 400 inclusive sub-Saharan African businesses.

> High sustainability portfolios consistently demonstrated lower volatility and experienced higher returns in 11 out of the 18 years

Businesses targeting low-income markets are found across the continent, but are unsurprisingly concentrated in more developed economies like South Africa and Kenya (see Figure 4). Contrastingly, unstable areas like Somalia and the DRC pose obvious challenges to operating any type of enterprise; these regions naturally include few inclusive enterprises. The association between economic development and governance capacity levels and the ability for inclusive businesses to thrive is expected. The conditions necessary for more traditional business activity also nurture businesses serving low-income communities.

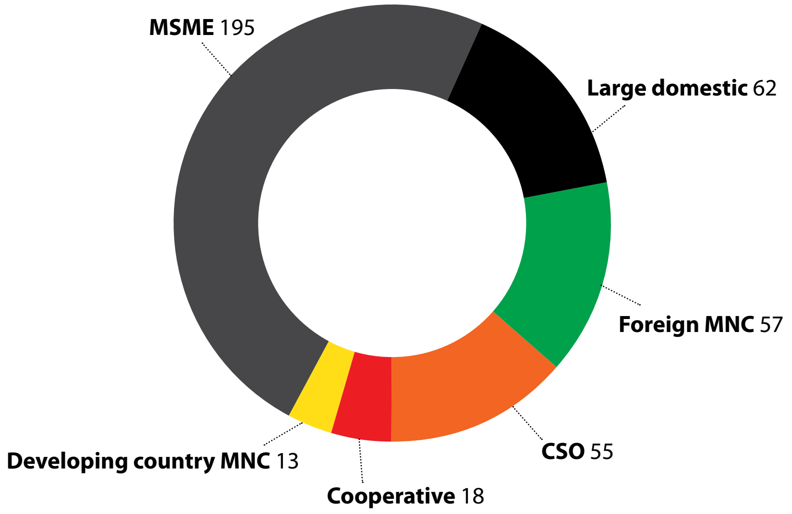
The greatest opportunities to create a meaningful space for low-income people as consumers,

Figure 4: Examples of inclusive business in sub-Saharan Africa, by country



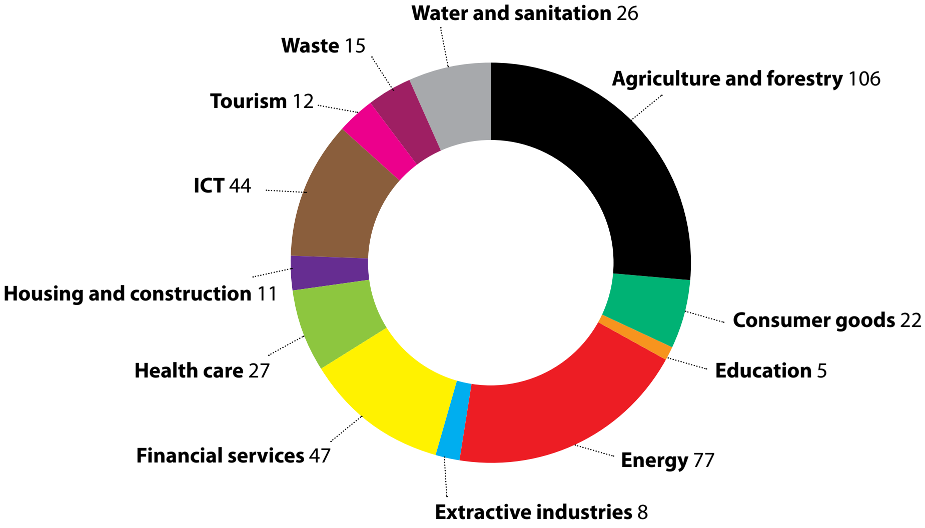
Source: UNDP, *Realizing Africa's Wealth: Building Inclusive Businesses For Shared Prosperity*, 2013

Figure 5: Examples of inclusive business in sub-Saharan Africa by type of organisation



Source: UNDP, *Realizing Africa's Wealth: Building Inclusive Businesses For Shared Prosperity*, 2013

Figure 6: Examples of inclusive business in sub-Saharan Africa, by sector



Source: UNDP, *Realizing Africa's Wealth: Building Inclusive Businesses For Shared Prosperity*, 2013

producers, entrepreneurs and employees are particularly evident in the agriculture and energy sectors (see Figure 6). Low-income households spend 7 per cent of their income on energy, making Africa's energy market worth $26.6 billion.[44] And agriculture still accounts for 60 per cent of Africa's active labour force and 34 per cent of the region's GDP.[45] Scholars argue that growth originating in agriculture is much more effective for increasing the incomes of extremely poor people than GDP growth originating in other sectors.[46] Former Prime Minister Diogo supports this view, proffering that because 70 per cent of Mozambicans rely on agriculture for their way of life, this is the sector from which reductions in inequality will be driven, not the country's mining sector, which is currently the source of so much investment and attention.

Challenges to Building Inclusive Models in Africa

Considerable innovation and business acumen thrive in sub-Saharan Africa; entrepreneurial ingenuity is even required to make up for a widespread lack of infrastructure. Yet, constraints in the business environment hamper the ability of even the most innovative, inclusive business solutions to reach a large scale. Weak regulatory frameworks, inadequate physical infrastructure and limited capital availability make African market conditions challenging for entrepreneurs and managers. Moreover, low-income communities generally initially lack the knowledge and skills required for productive participation in value chains.[47]

Private–Public Cooperation Fostering Inclusive Business

Inclusive enterprises cannot grow in a socio-political vacuum. These African business solutions necessitate a supportive environment to help them thrive, requiring private and public sector collaboration to build the appropriate 'ecosystem' to advance inclusive markets. A recent UNDP report, *Realizing Africa's Wealth,* identifies four areas of potential collaboration that currently hamper the growth of inclusive business solutions, these include: information, incentives, investment and implementation support. Below, the Paper briefly explains each of these challenges and includes suggestions from both African and Latin American[48] leaders – the two regions with the highest levels of inequality – on how to address these issues. Notably, these leaders saw government's most important role as providing a framework for implementation support and recognised businesses as the central source of job creation and growth.

Information

In order to initiate and sustain operations, businesses require an array of information, including material on existing models, market data and technical information regarding products and practices that might be integrated into the business. In addition, companies must understand the market characteristics, environment and economic trends of its targeted market. However, access to reliable data in Africa remains constrained by insufficient communication and connectivity and poor data collection. Moreover, data specifically related to low-income markets on the continent is limited.[49]

Addressing the Challenge

It is in the interest of governments to invest in data collection on economic performance and the potential of national assets. Even beyond having to collect information themselves, governments can engage international organisations and donors that assist with information gathering. Some institutions collect macroeconomic indicators and others assist by collecting information on investment prospects. Thomas Nziratimana, the General Manager for Government and Community Relations at TransAfrika Resources, noted the French geological survey conducted by the Bureau of Geological and Mining Research (BRGM) as an example of an organisation that builds national databases with information on nations' surface and subsurface resources and risk, informing investment prospects.

> Commercial prospects in Africa can be easily blocked without some incentive to invest

Though, he also notes data collection is not terribly expensive, and African governments are becoming more aggressive about data collection themselves. For example, the Government of Mali established a database that caught the attention of Mr. Nziratimana's own company, which is now planning to invest in the country. Nicky Prins, Chief Director of the South African National Capital Projects Unit, provided another example, explaining that 'in South Africa, the Department of Trade and Industry does significant market research, for example, on particular sectors they wish to promote'.

However, information gathering is not only beneficial for attracting FDI; organising a more structured market that facilitates the flow of market information can be essential for African farmers. Because agriculture is the backbone for most African economies, providing pricing information to farmers can play a crucial role in addressing disparities. Tony Elumelu suggests the government and private sector collaborate to organise commodity exchanges in order to tease out market information, which will encourage local farmers.

The Government of Malawi worked with AHL commodity exchange to establish more structured markets for its agricultural sector. Malawi's Trade Minister, Sosten Gwengwe, explained that in Malawi farmers have lost bargaining power and subsequently can only sell their goods at prices below market value. Minister Gwengwe noted the government 'is encouraging farmers to form cooperatives and use organized markets like the commodity exchange so they can have a say on price'.

And, in addition to collecting information for multinationals and local producers, gathering data that demonstrates the impact of businesses is crucial as well. Jonathan Oppenheimer sees measuring change in disposable income across different groups and sectors in an economy as an essential lens through which to view the effectiveness of government and private sector efforts in driving development.

Incentives

Commercial prospects in Africa can be easily blocked without some incentive to invest. While African governance is improving, business conditions remain generally poor, which can make securing profits difficult. Only two African nations – South Africa and Mauritius – make it into the top 50 ranking of the World Bank's ease of doing business indicators. And survey data reveal that business managers operating in sub-Saharan Africa spend between 5 and 10 per cent of their time dealing with regulators.[50]

Addressing the Challenge

Leaders consulted for this Paper agreed that getting institutions and regulatory frameworks right is an essential foothold in designing powerful incentives that can begin to address inequality. Governments can create substantial incentives to do business in their nations simply by ensuring reliable service operations. Chief Director Prins argues that 'more than incentives, I think businesses mainly want predictability, certainty and efficiency in government processes that govern their investments'. This means governments must stick to their policy decisions, ensure bureaucracy works efficiently and that regulations are not too onerous.

Former President of Costa Rica, Miguel Angel Rodriquez, points out that government is not just a 'set of silver bullets', but rather an institution that has to effectively manage day-to-day services. He argues governments should continuously re-examine how its services are delivered, just as would be done in any business. He asserts that 'right now we have too many regulations' to effectively manage institutions. This not only hampers states' abilities to align institutions in a way that reward and foster inclusive businesses, but also soils the general business conditions within a nation.

Once governments secure the management of institutions they can design incentives specific to inclusive businesses, as countries like Rwanda and Kenya have done. Thomas Nziratimana mentioned Rwanda's incentive system that encourages the formation of mining cooperatives. The Rwandan government awards mining licenses to cooperatives in areas unprofitable for large-scale companies; the licenses are not available to individuals, but rather only those workers who organise into cooperatives. Subsequently, workers become better organised and improve their negotiating position. Furthermore, these workers add value to products and pay taxes, importantly moving from the informal to the formal sector.

Former Kenyan Minister of Co-operative Development and Marketing, Joseph Nyagah, speaks with enthusiasm about the Cooperative Movement in Kenya: 'The Cooperative Movement, with a membership of about 10 million, is a major contributor to the Kenyan economy.' He noted that while the Movement started some 100 years ago in the agricultural sector, it can now be seen in all sectors of the economy, including finance, public transport and housing among others, representing about 43 per cent of Kenya's GDP and 25 per cent of total national savings.

Former Minister Nyagah explains that over the years, the Kenyan government has supported the Movement by ensuring a policy environment conducive to cooperative formation. For example, the government established a set of appropriate Cooperative laws, a separate Ministry of Cooperative Development that has operated at the Cabinet level, a Cooperative University College for specialised training and a Cooperative Tribunal court to handle disputes. In addition, the Ministry of Cooperative Development offers advisory and auditing services for these groups.

> Governments can create substantial incentives to do business in their nations simply by ensuring reliable service operations

The Kenyan cooperative policy environment acts as a powerful incentive for individuals to organise and establish inclusive businesses. According to Former Minister Nyagah, many informal businesses convert into cooperatives in order to take advantage of the cooperative laws. It becomes easier for these companies to raise funds because they are seen by banks as entities that have audited accounts and a governance structure similar to that of a corporate. Importantly, there is a clear legal structure for cooperatives in case of disputes, which is important as these organisations become larger.

Kenya's policy support of the Cooperative Movement has played a major role in making the nation's development more inclusive. It has contributed substantially to improvements in income in rural and urban areas, and it is a major player in reducing disparities. Cooperatives 'ensure poorer members of society are brought into the mainstream economy, and because cooperative business models are more democratic in nature it ensures the inclusion of all members'.

Investment

Like traditional enterprises, inclusive businesses often need initial investments to help them reach a point of operational stability. These funds can either come from the organisation developing the new business or from external sources. However, businesses targeting the low-income market in Africa are relatively risky, which makes equity investments expensive and hard to find. One survey revealed access to finance as a major obstacle for 44.9 per cent of African companies.[51]

Moreover, microbusinesses can somewhat easily find funding from microfinance lenders, and large companies can usually leverage capital internally or via investors. But, a 'missing middle' exists in Africa – those businesses looking for $1 000–$100 000 but have a hard time securing financing.[52] This gap leaves many inclusive concepts unrealised and a large market failure, estimated to be worth between $140 billion and $170 billion by the IFC and McKinsey Global Associates.[53]

Addressing the Challenge

Governments can help entrepreneurs by actively seeking funding from abroad in order to fill financing gaps. Thomas Nziratimana argues that 'when governments aren't proactive not a lot can happen. Governments must also be entrepreneurial'. All African nations have to compete to attract investors and governments must be proactive about doing so. One example Mr. Nziratimana gave was building an IT infrastructure to connect investors and entrepreneurs, arguing IT infrastructure must be part of government policy if you want 'people to get the right exposure'. Importantly, business leaders like Tony Elumelu think that in cases where African governments have encouraged the private sector to invest and have meaningfully engaged the private sector, it has helped to attract inward investment.

In addition, having a forum which fosters an ongoing relationship between government and the private sector is critical. Chief Director Prins explains that 'having the security of a formalized, ongoing forum that meets regularly is important to developing a relationship of trust, of constant flow of feedback and information sharing, and making mutual progress towards achieving solutions to problems that are often quite complex'. Governments need to be open and prepared to devote time to its commitment of working with the private sector in order to attract investment. Players from the private sector are generally very eager to join such initiatives because they see obvious benefits for themselves in the relationship.

Governments can showcase their progress with reform implementation and private-sector engagement through forums like KPMG's *Country Focus Series*. These events even dedicate some time to allowing local entrepreneurs to pitch their business plans to investors who, if interested, have the opportunity to meet with the entrepreneurs afterwards.

> Businesses targeting the low-income market in Africa are relatively risky, which makes equity investments expensive and hard to find

Governments could also do well by engaging development partners and foundations to meet financing gaps for SME entrepreneurs. Leaders interviewed argued aid money should be used to support entrepreneurs, especially those with inclusive business models, because entrepreneurial efforts eventually become productive and sustainable, unlike typical donations.

The Cooperative Movement is also a great example of innovative funding structures. According to Former Minister Nyagah, most cooperatives receive their funding through the savings and contribution of the individual members of the Cooperative Movement. He says 'this funding structure has allowed cooperatives to build factories, set up their own Savings and Credit Organizations, purchase public transport vehicles, put up both commercial residential properties and establish Kenya's second largest insurance company and the nation's third largest bank.' Though notably, Former Minister Nyagah also explained the Movement received 'substantial funding from the donor community, especially in the early days of Independence'.

Implementation Support

Businesses depend strongly on a range of intermediary and support services, especially those operating in low-income markets, which is inherently more challenging. Physical infrastructure in poorer areas is insufficient; more than 70 per cent of sub-Saharan Africa's rural population lives more than two kilometres away from an all-season road.[54] And knowledge of formal enterprise, business skills and financial services are limited in these areas.

Addressing the Challenge

Leaders largely recognised implementation support as the area most important for governments to act on. For instance, Dr. Kaberuka appreciates the need to optimally utilise African skills and its diversity of labour, and therefore sees value in tackling the myriad challenges preventing the easy movement of Africans across the continent's borders. Physical infrastructure, especially energy supply and education, were the two areas in which leaders saw the most opportunity to improve implementation support.

Dr Kaberuka noted that in some respects 'people living in darkness is the greatest form of exclusion' – only 20 per cent of Africans have stable access to electricity. And 'to actually drive and address the issue of inequality, the provision of electricity across societies is essential'. Dr Kaberuka argues that if nations can establish proper institutions by securing independent regulators 'in law and in fact', energy could be the next revolution in Africa. Accordingly, the AfBD is trying to encourage governments to focus on institutions and infrastructure. While the infrastructure financing gap for African nations may appear big, Dr Kaberuka argues 'it's peanuts' for the private finance sector. By working with the private sector to facilitate access to electricity, governments will increase access to economic opportunities across the continent.

> If nations can establish proper institutions by securing independent regulators 'in law and in fact', energy could be the next revolution in Africa

Notably, other leaders stressed the importance of education for the success of business implementation. Former President Rodriguez explained that the 'quality of the workforce depends very heavily (on the quality of national education)'. He even recognises the rising levels of inequality in Costa Rica as an effect of insufficient education that largely lost its quality as it was expanded across the country. Leaders consulted discussed the imperative to reconsider technical schools as part of national curriculums in order to better prepare students for the working world. However, these leaders also warned of the easy mistake of training students in skills no longer needed for the workforce. And former President of Nigeria, Olusegun Obasanjo, made the important point that while 'education is very important … it must be matched with job creation or the educated will be very frustrated'.

Conclusion

The sense of growing African disparities is almost tangible. As pockets of vast wealth grow, swathes of impoverished proliferate. Increasingly frustrated by their economic exclusion, many poor Africans see governments as the culprit, citing corruption that interrupts an equitable flow of resources and services. Others identify the private sector as the offender, pointing to the *extractive* nature – as they see it – of Africa's growth and the failure to produce sufficient employment and services in low-income markets.

And while the impact of inequality has historically been contested, new data demonstrates that high levels of inequality generally slow growth. Disparities hamper development through a number of channels. Inequality can undermine the creation of a consumer class and therefore deny nations productivity gains in manufactured products. Capital market imperfections created by disparities stall human capital formation and investments in low-income markets. Inequality can leave elites disproportionately in control of state policies, creating inefficiencies. And, perhaps most noticeably, inequality slows growth by instigating social instability, denying new and continued investment opportunities among other things.

Nicky Oppenheimer has argued that 'only be reexamining the way we do business today will we meet the challenge (of supplying unmet needs)'.[55] African business leaders must aim to align commercial and developmental objectives to ease felt disparities and – notably – unlock their growth potential. By doing so, firms create the potential to access latent markets, increase price performance, attract superior human capital, expand innovations developed in low-income markets, improve their competitive position through brand recognition and realise greater and less volatile returns. According to Nicky Oppenheimer, redesigning business models to meaningfully incorporate concern for its social impact is the only way for businesses to 'secure a real competitive edge'.

Promisingly, businesses with explicit aims to incorporate low-income markets are cropping up across Africa. While these models are concentrated in more developed African states, the collection is diverse, including MNCs, SMEs and small local businesses. And they hold considerable potential to support economic growth and create a more equitable distribution of gains resulting from development. For example, Africa's energy market is already worth $26.6 billion and agriculture still accounts for 60 per cent of Africa's active labour force; these are the two sectors with the highest inclusive activity.

Yet, these inclusive business solutions do face the common challenges to doing business in Africa and especially low-income markets. Hence, governments must create favourable business conditions so these inclusive and sustainable solutions can thrive. Senior leaders are ever more aware of which strategies are ineffective: as Dr. Kaberuka pointed out, 'we know for sure those policies which kill growth'. And avoiding these policy schemes should be the foundation of African policy making. However, senior officials consulted for this paper have also offered some concrete steps governments can take to improve entrepreneurs' and managers' access to information, incentives, access to funds and implementation support.

Both public and private actors must remember the success of economic development depends on the ability to include all people in growth.

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Endnotes

1 The reflections on inequality from senior Africans and Latin Americans cited in this Paper were collected by the author during a high-level dialogue in South Africa between 22–24 November 2013 and reproduced here with their kind permission.

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