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Research Article

Trade and Industrialisation in Africa: SMEs, Manufacturing and Cluster Dynamics

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ABSTRACT

Trade in manufacturing through global and regional value chains has played an especially prominent role in global economic growth in recent decades. However, Africa faces severe challenges in growing manufacturing activities in the face of China and Southeast Asia's competitive dominance of global manufactured product markets. Traditionally, global trade is heavily concentrated at the corporate level. But this reliance on large firms as a driver of trade is problematic for Africa given its need for a more inclusive synergistic trade and economic growth path that is more employment intensive, more decentralised and which provides scope for enhanced activities by indigenous and small-scale industry. This is not to argue for the exclusion of large firms or foreign direct investment in economic growth, but rather to argue the case for an increased presence of indigenous small-scale firms in the economy and in export trade. There is evidence of dynamism in Africa, both within individual Small- and Medium-sized Enterprises (SMEs) and in clusters of SMEs. In understanding the challenges faced by this sector, and in examining the prospects for their participation in external trade, we review the experience of 25 African clusters using four dimensions: the nature of unintended externalities (e.g., external economies), market orientation and upgrading and growth trajectories, cluster dynamism and joint action for upgrading, external institutional support and upgrading. In terms of policy challenges for SMEs and export trade we discuss four major areas: (i) participation in governed global value chains feeding into high-income markets, (ii) export sales to non-regional low-income markets, (iii) export sales to regional markets and (iv) informal sector cross-border trade to regional economies. We conclude that for Africa, trade and industrialisation are integrally linked and attempts to facilitate regional trade policies cannot ignore the need for developing appropriate industrial policy and adopting an approach of developmental regionalism. This is especially evident with respect to SME development.

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1. INTRODUCTION

The recognition that structural transformation and productivity growth provide the key to enhancing growth is a core component of economic theory and economic policy. These objectives could be met, Adam Smith argued, through the division of labour within and between enterprises. Further, added Smith, the division of labour was a function of the size of the market—the larger the market, the greater the scope for specialisation. Coupled with Ricardo's argument that specialisation in comparative advantage allows for win-win outcomes through exchange, these core ideas in classical economic theory provide an effective rationale for international trade, especially for small- and medium-sized economies with limited domestic markets.

Trade in manufacturing has played an especially prominent role in global economic growth, particularly in recent decades. This is partly because the manufacturing sector has been the major arena for technological change and productivity growth, partly because linkages in manufacturing spread efficiency gains across the manufacturing sector and to other sectors, and partly because manufacturing's employment intensity has helped to spread the gains from exports and economic growth. However, African manufacturing faces severe challenges in growing manufacturing activities in the face of China and Southeast Asia's (SE) competitive dominance of global manufactured product markets. This impact occurs in two forms: indirectly blocking African-manufactured exports' market growth in third-country markets, and directly through African manufacturing producers being undermined by cheaper Asian imports (Edwards and Jenkins, 2015; Kaplinsky, 2008; Morris and Einhorn, 2008). A more recent indirect development is the potentially destructive impact of export of raw materials to China and SE Asia economies which inhibits local production through a reduction in the availability of inputs or an increase in their prices. For example, the export of raw timber from Gabon to China undermines local processing into higher-value added veneer products which had previously been exported to Europe (Kaplinsky et al. 2011). The felling of wild shea trees in Ghana and Burkina Faso and their (mostly illegal) export to SE Asia as timber for furniture production constrains the local Small- and Medium-sized Enterprise (SME)-based shea butter processing industry. Likewise, the export of scrap metal to Asian economies starves domestic metal fabricating SMEs of access to cheap local inputs.

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The observed reality of 300 years of economic progress since the onset of the Industrial Revolution is that economic growth and cross-border trade have gone hand in hand. Global trade is heavily concentrated at the corporate level. It was estimated that at the turn of the millennium the largest 500 global firms controlled 70% of global trade.¹ Hence, it is natural to conclude that economic growth in Africa can best be fostered by facilitating a growth in manufacturing exports by large firms. And because there is a dearth of large indigenous firms in many African economies, this will necessarily involve increased foreign investment. Many African economies have concentrated on this route to export growth, including through the promotion of export processing zones.

This reliance on large firms as a driver of trade is problematic, not least on the African continent. For one thing, large firms tend to be capital intensive, and unemployment is perhaps one of the greatest challenges facing Africa. Between 2000 and 2008, the rate of employment growth was less than half that of economic growth, and even though the rate of employment speeded up between 2009 and 2014, it still lagged economic growth by an average of 1.4% annually (UNECA, 2017). Slow employment growth disproportionately affects women and youth (Africa's youth population is anticipated to grow from 226 million in 2015 to 321 million by 2030) and has enormous poverty and political impacts. In recent influential papers, Rodrik has presented evidence to show that manufacturing is unlikely to be a major source of employment growth globally (Rodrik, 2016; Rodrik, 2018a). Further, on the basis of growth trends in Africa involving manufacturing exports by large firms in Global Value Chains (GVCs), he has expressed particular pessimism about the capacity of export trade to make a significant contribution to meeting Africa's employment challenge (Rodrik, 2018b). Moreover, with the advance of the *Fourth Industrial Revolution* there is widespread recognition that, globally, employment growth will pose a major challenge to society and economic policy.

From the African perspective there is an additional employment challenge to be confronted, and that is the limited capacity of the formal sector to absorb labour. As in other parts of the developing world, a very large proportion of Africa's labour force earns its incomes in the informal sector. This is particularly the case for Sub-Saharan Africa (SSA), as Table 1 indicates, where more than two-thirds of employment outside of agriculture is in the informal sector, and this proportion has grown.

Hence, it is critical to find a route to a synergistic trade and economic growth path which is more inclusive, that is, one that is more employment intensive, more decentralised and which provides scope for enhanced activities by indigenous and small-scale industry. This is not to argue for the exclusion of large firms or Foreign Direct Investment (FDI) in economic growth, but rather to argue the case for an increased presence of indigenous small-scale firms in the economy and in export trade. However, before addressing the evidence in this regard, it is necessary to highlight six related key drivers of global trade which have grown in importance since the mid-1980s.

The first of these is the centrality of GVCs in trade. In recent decades value chains have become increasingly fragmented and this follows directly from the division of labour anticipated by Adam Smith. In a highly competitive world, in which the degree of competition has heightened with widespread trade liberalisation, producers have specialised in core competences in which their command over producer and product rents provides barriers to competition. Activities in the chain which are not protected by entry barriers are outsourced. Increasingly this outsourcing has taken a global dimension such that value chains have evolved into GVCs. The definition of GVCs in trade statistics involves the exchange of products involving productive activities in more than two economies. United Nations Conference on Trade and Development and the World Trade Organisation calculate that this trade now accounts for more than two-thirds of total global trade.² Much of this global trade is in intermediates, rather than in raw materials or finished products.

The second relevant development is the extent of governance of trade in GVCs. In many cases, global trade continues to occur on the arms-length basis beloved by economic texts; some of this is within GVCs as it involves more than two economies in the production process. However, the growing complexity of trade in intermediates, particularly in products involving the assembly of imported intermediate inputs, has enhanced the significance of logistics in managing these global production systems. The need for sophisticated logistics controls is heightened by just-in-time production which necessitates delivery reliability and total quality control along the chain. In addition, the fragmenting of final product markets requires careful control over the distinctiveness of intermediate inputs. Consequently, an increasing (although unmeasured) proportion of trade in intermediate products requires detailed control by lead players in GVCs, that is, *chain governance*. Here, there has been a pervasive growth in the importance of buyers in many sectors (Gereffi, 1999). For example, in the case of final *simple* consumer goods, retail chains, category buyers and other intermediaries dominate the organisation of global production and

Table 1 | The share of informal sector work in non-agricultural employment by region in low- and middle-income economies, 2000–2004 and 2005–2010 (%)

	2000–2004	2005–2010
North Africa	47.3	53.0
Sub-Saharan Africa	63.3	70.0
Latin America	55.9	57.7
South and Southeast Asia	Not available	69.7
Transition economies	20.7	22.6

Source: drawn from Charmes (2016).

¹<https://www.sharing.org/information-centre/articles/multinational-corporations-overview>.

²An interesting anomaly is the extent of double counting on global trade statistics; for example, the screen in a mobile phone is calculated twice, once as an export from Korea to China, and then subsequently as incorporated in the final value of the mobile phone exported from China to the world. This is estimated to have led to a 28% overestimate of the value added in global trade (UNCTAD, 2013). The trade in value added (TIVA) database developed collaboratively by the WTO and the OECD seeks to decompose global trade into gross and net flows across borders (<http://www.oecd.org/sti/ind/measuring-trade-in-value-added.htm>).

exchange along the chain. In more *complex* durable goods such as automobiles and electronics, the chains are dominated (i.e., *governed*) by lead firms who control access to supply chains and determine the rules of incorporation.

Third, a primary mechanism of governance in GVCs are the standards which suppliers have to meet to be included in the chain (Kaplinsky and Morris, 2018). Typically, at the corporate level, the key standards are Q–C–D. This involves requirements with regard to quality (Q), demands for cost-containment/reduction (C) and reliability and frequency of delivery (D). If suppliers do not conform adequately, they may have to pay a penalty or receive lower prices (or both), or be ejected from the chain. However, corporate standards are not the only set of standards affecting gainful participation in GVCs. In an increasing number of final product markets, civil society organisations set standards affecting the conditions under which production occurs, such as with regard to labour standards and the environmental provenance of production processes. While both corporate and civil society GVC standards involve a trade-off between the degree to which standards are met and the rewards to suppliers, governments and intergovernmental bodies such as the European Union set regulations which determine entry into final markets. These regulatory standards provide no scope for the degree of conformance and are a basic requirement for market entry.

Fourth, the extent of governance and the character and importance of standards are critically determined by the nature of the final market. In general, the higher are per capita incomes in the final market, the greater is the degree and complexity of governance and resultant standards in GVC trade. This applies not just as a basic differentiator between the economies to which exports are destined, but also to the niches which are served within different economies. Some markets in low-income countries involve standard-intensive value chains, and similarly, some low-end markets in high-income countries are relatively standards free (Guarín and Knorringa, 2014).

Fifth, the relative importance of intraregional trade at a global level is often underestimated. *Made in China* is in reality often *made in East Asia*. Formal regional agreements not only facilitate the movement of goods across regional borders, but also of people and capital. Much of this regional integration occurs within the framework of Regional Value Chains (RVCs), through regional economic hubs and decreased transport costs expanding the scale of regional markets and the scope of regionally based FDI and production. When RVCs create backward and forward linkages, this often spills over local borders and extends the scope of regional integration. Hence, regional integration is often integrally intertwined with RVC expansion and linking to global trade through GVCs (UNIDO, 2018).

In Asia such economic hubs, coupled with shared norms and institutions which facilitate trust networks and reduced transaction costs, have expanded regional economic integration. These have expanded the scope of RVCs and their integration into export-oriented trade to the extent that “value chains are often organized regionally rather than globally” (UNIDO, 2018; p. xviii). As a consequence, “Southeast Asian economies source over 40% of their foreign value added in exports from Asian partners” (UNIDO, 2018; p. 18).

Likewise, in SSA there is evidence that regionally determined rules of origin have facilitated market entry into economic hubs. Regional market entry is governed by large regional retail firms, and the RVCs which arise are driven by large regionally located manufacturing firms, building cross-border supply chains in the process. However, unlike Asia, these have often resulted in an integration between RVCs and GVCs in global export-oriented industries. For example, the large foreign Transnational Corporations (TNCs) which dominate apparel exports to the United States and European Union have not, at least yet, created backward supply chain networks throughout the region (Morris et al., 2016).

Finally, and this goes almost without saying, global markets have become increasingly competitive as trade liberalisation has proceeded and as production capabilities have grown globally. Producers who are unable to improve their offerings (in production processes, product character or both) are either excluded from the market or experience extreme pressure on margins. In the worst case, surviving firms and economies are driven into an *immiserising growth path* in which incomes fall despite an increase in the resources devoted to production and exchange. Hence, the capacity to upgrade, continuously and not just as a single action, is key to gainful participation in global export markets.

We now turn to a discussion of the factors which determine the gainful participation of SMEs—including those in the informal sector or the margins of the formal sector—in the growth of global and especially regional exports in African economies.

2. “THE PROBLEM FOR SMEs IS NOT THAT THEY ARE SMALL, BUT THAT THEY ARE LONELY”³

By virtue of their size, SMEs are confronted by a number of challenges which undermine their competitive capacity. These affect their direct costs of production (transforming inputs into outputs), their indirect production costs (product development and design, supply chain management and marketing) and their control over input and output markets.

With regard to direct expenditures which affect the variable costs of production, capital goods may have inherent scale economies. For example, the ratio of volume to circumference in spherical containers is 1.6, which provides an important impetus to scale in the chemical and biological process sectors. Even when these scale economies are not technologically determined, the global concentration of Research and Development (R&D) in large firms and high-income economies means that the spectrum of efficient technologies available for purchase is often in reality confined to large-scale and capital-intensive techniques. With regard to indirect costs of production, the capacity to defray investments into R&D, marketing and logistics is a function of scale—spreading these fixed costs over large volumes of sales. The financial muscle of large firms allows them to drive down the price of inputs, to offer financial incentives to obtain market share and to gain from privileged access to low-cost and long-term finance. Finally, the inability to produce in large volumes excludes SMEs from feeding into value chains serving large and often global markets.

³This characterisation of SME cluster dynamics is drawn from Schmitz (1995).

By contrast, SMEs benefit from a number of competitive advantages. They are often flexible and agile; not being held back by large corporate bureaucracies allows them to respond rapidly to changing market conditions. SMEs are often particularly adept in developing new products and technologies, and are not weighed down by path-dependent innovation trajectories (Dosi, 1982; Nelson and Winter, 1982). They are often able to escape costly compliance to regulatory regimes, including with respect to minimum wages, health and safety, and child labour. Their bureaucratically thin administrative structures endows them with lower cost structures than their large corporate rivals. Although their incapacity to produce in large volumes constrains their capacity to feed in as suppliers into large-volume value chains, small volume production allows them to serve small-scale and niche markets.

While in many cases, such as in the chemical sector, SMEs are disabled by inherent technological constraints, in other cases seemingly insurmountable scale challenges can be surmounted. For example, with regard to the direct costs of production, there are often alternative sources of technology which can produce effectively at low volumes. In East Africa, in the furniture, apparel and farm-mechanisation sectors small producers have rapidly switched their capital goods imports from large-scale equipment sourced from Northern economies to smaller-scale and cheaper equipment sourced from China and India (Agyei-Holmes, 2014; Atta-Ankomah, 2014; Botchie, 2015; Hanlin and Kaplinsky, 2016). In recent years, the development of mobile telephony and its rapid expansion in Africa reduces many of the indirect scale barriers, linking individuals into global and regional information sources, and hence, allowing small producers to shop around for alternative suppliers and alternative markets (Aker and Mbiti, 2010). Moreover, indirect costs can be shared with other firms—for example, as will be shown below, SMEs can effectively market their produce under a shared brand name. And in relation to market power, SMEs can join together to purchase collectively and hence to drive down input costs.

Globally, there are many examples of vibrant clusters of SMEs who compete effectively in export markets, particularly in the early stages of an industry's development.⁴ Perhaps the most widely cited case is that of the *Third Italy*. During the 1970s and 1980s, Italy was the world's largest net exporter of furniture, apparel and footwear, yet in each of these sectors the average firm size was <11 employees (Best, 1990). But, clusters of SMEs in industrial districts are not confined to either Italy or high-income economies. Between 1970 and 1990, a cluster of almost 2000 firms in the Sinos Valley in Brazil specialised in the production of women's shoes and raised its share of world leather footwear exports from 3% to 12%. By 1991 they exported nearly 100 million pairs of shoes annually, valued at \$900 million. These firms covered a range of links in the footwear value chain, and created more than 15,000 jobs (Schmitz, 1999). The surgical instrument cluster in Sialkot, Pakistan, produces scissors, forceps, and other precision instruments using stainless steel. In the late 1990s it comprised more than 300 manufacturers, subcontracting work to more than 1500 SMEs, and sourcing inputs from 200 local suppliers and more than 800 service providers. Over 90% of output was exported and the cluster accounted for more than 20% of global trade, making Pakistan the second largest exporter after Germany (Nadvi, 1999).

So, what explains the dynamism of clusters and the predominance of small firms within many of them? Industrial districts are not a new phenomenon and their significance in the UK's industrial development was analysed by both Alfred Marshall and Karl Marx. Marshall's explanation of clustering, which he referred to as *industrial districts*, was ascribed to *external economies* arising from colocation. Examples of external economies are a pool of skilled labour, the agglomeration of suppliers, the pull of buyers to locales where they had a choice of suppliers and the development of specialised support institutions and service providers (Marshall, 1969).

More recently a distinction has been drawn between the simple and unintended external economies resulting from colocation observed by Marx and Marshall, and collective efficiency when firms in the cluster engage in purposeful, planned joint action (Schmitz, 1995). This collective action can take a number of forms, including joint purchasing of inputs, joint market intelligence and marketing, product development, skills upgrading and lobbying for support from government. When policy design and delivery are effective, cluster dynamics are greatly aided by appropriate backing from local and national governments (Best, 1990; Van Dijk and Sverrisson 2003; Morris and Barnes, 2006; Morris and Robbins, 2007). The most dynamic clusters, particularly in contexts of a challenging external environment, tend to be characterised by joint actions of various forms. Furthermore, critically, particularly in the context of increasingly competitive global markets, cluster dynamics and sustainable and inclusive growth depends on the capacity of individual enterprises and their clustered collectivity to upgrade their offerings (Pietrobelli and Rabellotti, 2011). This requires product development, improvements in process, the adoption of new business strategies, the penetration of new markets and sustained investments in joint action.

3. SMEs, CLUSTERS AND INDUSTRIAL DISTRICTS IN AFRICA

Clusters of SMEs are pervasive throughout Africa. Visitors to any city or peri-urban town cannot fail to notice the hive of activity of small enterprises, many of whom are engaged in the same line of business. Characteristically, a large proportion of these are *informal*, operating in sheds barely protected from the elements and with poor and unreliable access to infrastructure such as power and water. Indeed, as discussed earlier, in SSA the informal sector provides more than two-thirds of employment outside of agriculture.

The predominant view is that these SMEs, particularly those in the informal sector, are *survivalist*, providing meagre incomes and with little capacity to upgrade their operations. The reality, however, is much more complex. True, there are very many SMEs and very many clusters which scrape along the bottom of subsistence production, displaying few signs of dynamism. In the same way, even in high-income economies, there is widespread failure in the SME sector, and routinely, nine out of 10 start-ups fail. Yet, at the same time there is evidence of dynamism in Africa, both within individual SMEs and in clusters of SMEs. In understanding the challenges faced by this sector, and in examining

⁴See Van Dijk and Sverrisson (2003) for an extended discussion of various types of clusters in developing countries.

⁵All of these observations are judgements made on the basis of publicly available material on the nature and the performance of these 25 clusters (see Kaplinsky and Morris, 2014) for the detailed sources). It is not possible to subject these clusters to any form of numerical analysis because each of these clusters has been documented in a different form.

Table 2 | Africa's experience with 25 clusters

Cluster	End market	Evidence of dynamism	External economies	Collective action	Forms of institutional support
Egypt	Domiat furniture (Domestic)	Local, national	None	None	Cluster/sectoral
	Domiat furniture (Export)	International	Growth, upgrading	Marketing, learning, logistics	External
Ethiopia	Merkato leather footwear	Local, national	None	Logistics	Government, cluster/sectoral, external
	Shiro Meda handloom	Local, national	None	None	External
Ghana	Suame metalwork	Local	Upgrading	None	Government
	Suame vehicle repair	Local, regional	None	Learning	Government, cluster/sectoral, external
Kenya	Gikomba furniture	Local	None	None	None
	Ngong furniture	Local	Growth	None	None
	Kibuye furniture	Local	None	Logistics	Cluster/sectoral
	Eastland garment	Local	None	None	None
	Kamukunji metalwork	Local	None	Marketing, learning	Government, cluster/sectoral
	Ziwani vehicle	Local	Upgrading	Learning	Cluster/sectoral, external
	Lake Victoria Nile Perch	Local, national, international	Growth, upgrading	Logistics, learning	Government, cluster/sectoral, external
	Lake Naivasha cut flower	International	Growth, upgrading	Marketing, learning, logistics	Government, cluster/sectoral, external
Nigeria	Otigba computer hardware	National, regional, international	Growth, upgrading	Marketing, learning, logistics	Cluster/sectoral
	Nnewi auto parts	National, regional	Growth, upgrading	Logistics	Cluster/sectoral, external
Mauritius	Textile and Clothing	International	Growth, upgrading	Marketing, learning, logistics	Government, cluster/sectoral, external
South Africa	Cape clothing and textile	National	Growth, upgrading	Logistics, learning	Government, cluster/sectoral, external
	KZN clothing and textile	National	Growth, upgrading	Logistics, learning	Government, cluster/sectoral, external
	Durban automotive	National, international	Growth, upgrading	Marketing, learning, logistics	Government, cluster/sectoral, external
	South African wine	Local, national, international	Growth, upgrading	Marketing, learning, logistics	Government, cluster/sectoral, external
Tanzania	Mwenge handicrafts	Local, national, regional	Growth	Learning, marketing	Government, cluster/sectoral
	Gerezani metalworks	Local, national	None	Learning, marketing	Government, cluster/sectoral
	Keko furniture	Local, regional	Growth	Learning, marketing	Cluster/sectoral
Uganda	Fish processing	Local, national, international	Growth, upgrading	Logistics, learning	Government, cluster/sectoral, external

Source: the sources for these individual studies are cited in [Kaplinsky and Morris, 2014](#).

the prospects for their participation in external trade, we review the experience with innovation of 25 African clusters.⁵ These span nine economies, namely, Egypt, Ethiopia, Ghana, Kenya, Nigeria, Mauritius, South Africa, Tanzania and Uganda (Table 2). They include clusters in the south, east, west and north of the continent, and in both the manufacturing and agricultural sectors. These African cluster experiences are considered in the light of the major determinants of cluster dynamics in other regions of the global economy reviewed earlier.

In reviewing the experience of the cluster dynamics, the first consideration is to map the nature of external economies which arise from colocation. These are the spillovers between colocated enterprises which are unplanned, in particular with regard to labour and skills, the proximity of suppliers and customers and the extent of specialisation between firms. The second aspect considered is the nature of the market for the cluster's output and the relationship, if any, between the locale of the market and the cluster's upgrading capabilities. Third, beyond unintended external economies lies the possibility of joint action between enterprises, distinguishing in our analysis logistics, marketing and training. Finally, the institutionalisation of assistance to each of the clusters reflects the nature and effectiveness of policy support. This support may be provided by government, by formal associations developed by the private sector and by parties external to the economy, such as lead firms or aid agencies. We assess the significance of innovation in these cluster dynamics by classifying them in terms of their growth performance (sales/employment) and our reading of the case studies with regard to their capacity to innovate and to upgrade their processes, products and business organisation.

3.1. The Nature of Unintended Externalities

Each of these clusters, by definition, involves the colocation of SMEs in a similar sector of activity. As we observed earlier, clusters arise as a consequence of spillovers between enterprises. All of the 25 African clusters benefit from at least one of four categories of external economies: (1) labour skills spillovers, (2) proximity of suppliers, (3) proximity of customers, (4) the development of interfirm specialisation and the division of labour. Table 3 summarises the prevalence of individual external economies in these 25 clusters. It shows that 12 of the clusters benefit from all four types of spillover, eight benefit from three types and five benefit from two types of externalities. In none of the clusters did firms benefit from only one type of external economy.

3.2. The Location of Final Markets and Links to Cluster Upgrading

As observed earlier, Adam Smith identified the critical importance of the size of the market as a facilitator of productivity growth. However, it is not just the scale of the market which influences productive dynamics—the character of demand also plays an important role. Wider markets beyond the locale of the producer may be more competitive and may embody demand characteristics which force the producers to innovate in order to survive. Indeed, one of the key contributions of the GVC analytical framework has been to evidence how the supply-push productive systems which developed in conditions of scarcity after World War 2 have increasingly had to shift to demand-pulled trajectories (Gereffi, 1999; Kaplinsky and Morris, 2001). Innovation studies also evidence the role which users may play in product and process upgrading (von Hippel, 2005).

There is a clear pattern in the relationship between the location of the final market and the dynamism of the clusters (Table 4). Each of the three clusters selling primarily into global markets, the six clusters selling into national markets and the 10 clusters selling into domestic and regional markets, shows signs of both sustained growth and innovation. By contrast, the seven clusters selling into the immediate vicinity show the least signs of growth and innovation—they are predominantly survivalist clusters. It is not possible to determine the direction of causality in these numbers, that is, whether only dynamic clusters are able to sell outside local markets, or whether the act of selling outside local markets leads to enhanced growth and upgrading.

Table 3 | The nature of external economies in clustered enterprises

Evidence of external economies	Number of clusters
Availability of labour supply	18
Availability of suppliers	23
Customer attraction	22
Interfirm specialisation	19
Two external economies	5
Three external economies	8
All four external economies	12

Table 4 | Market orientation and upgrading and growth trajectories

Market orientation	Evidence of dynamism			Number of clusters
	Growth	Upgrading	Growth and upgrading	
Local only	1	2	0	7
Domestic (local and national)	2	2	2	6
Domestic and international	5	5	5	5

3.3. Joint Action and Upgrading

International experience shows that clusters achieve collective efficiency when members build on these accidental external economies and take deliberate joint action to strengthen cluster performance. Table 5 considers three types of joint action—skill development, marketing and logistics—and the extent to which this is associated with cluster dynamism. Three-quarters of the 16 clusters cooperating in skill development have experienced sustained growth or upgrading, or both. A smaller number of clusters cooperated in either marketing (10 of 25 clusters) or logistics (11 of 25 clusters). Logistics cooperation is particularly closely associated with growth and upgrading, whereas joint marketing does not appear to be as important. The more clusters engaged in different types of joint action simultaneously, the more likely this was associated with cluster dynamism. Once again, causality cannot be imputed from these aggregate data alone.

3.4. External Support and Upgrading

There are a variety of forms of institutionalisation of joint action activities. One source of support is through government, either national or local government, or both. Another form of institution is that created by the members of the cluster itself, or by sectoral associations. These institutions are both private sector driven. The third form of support is provided by parties external to the economy, such as through aid or Non-governmental Organisations (NGOs). Table 6 shows the distribution of these institutional support programmes in the 25 clusters. The largest number of clusters received multiple types of support—from government, through the firm's own contributions and from external sources. Four of the clusters support institutions were entirely the result of private sector cluster and sectoral initiatives, and an additional three involved collaborations between governments and the private sector.

4. FURTHERING AFRICAN SME EXPORTS IN GLOBAL MARKETS

To briefly recap the discussion so far on the basis of global experience, the preceding discussion has reviewed six major developments relevant to SME participation in global trade. First, without the capacity to upgrade, and in the context of a highly competitive and liberalising global economy, sustainable growth cannot be achieved. Second, drawing on the work of Adam Smith, GVC analysis and innovation studies, the capacity to upgrade and the direction of upgrading are a function of market size and market characteristics. External trade is an important conduit for increasing market size, particularly for economies with small markets. Third, the greater share of global trade occurs within GVCs, and a large proportion of this is *governed*, subject to exacting market preferences, and consequently involving standard-intensive value chains. Fourth, and perhaps surprisingly, in many parts of the world SMEs manage to participate in export markets, but this invariably involves colocation in industrial clusters and various forms of collective action. Fifth, regional markets play an important role in enabling developing-country firms, especially SMEs, to learn about exporting, in many cases through less standard-intensive RVCs as a transition to GVCs. Sixth, despite the overwhelming preponderance of informality in African clusters, there is evidence of growing SME participation in wider markets and related enterprise and cluster dynamism.

Unfortunately, there are no measures of the extent and share of SMEs in Africa's trade. However, given the need to enhance the inclusivity of growth paths in Africa, and given the latent and exploited competitive advantages which SMEs possess, there is clearly an important policy

Table 5 | Cluster dynamism and joint action

Evidence of collective activity	Evidence of dynamism			Number of clusters
	Growth	Upgrading	Growth and upgrading	
Learning	12	11	10	16
Marketing	8	6	6	10
Logistics	10	10	10	11
One collective activity	0	3	2	5
Two collective activities	7	5	5	9
All three collective activities	5	5	5	5

Table 6 | Institutional support for joint action

Evidence of institutional support	Number of clusters
Only government	1
Only cluster/sectoral	4
Only external	2
Government and cluster/sectoral	3
Government and external	1
Cluster/sectoral and external	2
Government, cluster/sectoral, external	9

requirement to enhance their participation in both regional and national markets. We can group these policy challenges in four major areas, the first three of which predominantly involve formal sector SMEs: (i) participation in governed GVCs feeding into high-income markets, (ii) export sales to non-regional low-income markets, (iii) export sales to regional markets and (iv) informal sector cross-border trade to regional economies. The analysis and policy prescriptions which follow address SME participation in global trade as exporters. There is an analogous discussion to be pursued with regard to imports by SMEs which can be both productivity enhancing (cheaper and better inputs) and consumer welfare enhancing (cheaper and better consumption goods), but these are outside the scope of this paper.

4.1. SMEs Exports to High-income Markets⁶

Exports to high-income markets involve a number of characteristics, each of which poses particular challenges for SME exporters. First, despite the existence of niche markets, the scale of demand is invariably beyond the reach of individual SME exporters. This is particularly the case in the non-durable good markets served by relatively low-tech African SMEs. Second, these markets are often finely segmented, with distinctive consumer preferences. Market intelligence, often quite sophisticated and costly to generate, is required to understand and serve these demanding consumers. Third, many of these markets are dominated by retail chains, large intermediaries such as category buyers purchasing for retail chains, large first-tier TNC or emerging economy firms with subsidiaries in low-income countries supplying retailers (termed *triangular manufacturing* by Gereffi, 1999) and global brands. These buyers not only purchase in large volumes, but also require conformance to exacting process and product standards along their chain.⁷ In addition, governments in high-income markets impose a variety of regulations which limit market entry if producers are unable to conform to specified standards. The GVCs in which exporters are incorporated are thus heavily governed by lead firms. They also invariably involve certification costs which are beyond the reach of individual SMEs. For example, for enterprises employing up to 400 workers (considered as SMEs by many certification service providers but which are large firms in much of Africa), the quality certification costs to meet International Organisation for Standardisation (ISO) standards are fairly onerous. The industry certification rate is \$850/day and the time (days) required for certification range from 2 days for an enterprise with 6–10 personnel up to 10 days for 276–425 personnel. Certifying environmental management standards likewise ranges from 3.5 days to 15 days, respectively (Kaplinsky and Morris, 2018).

The costs of meeting these requirements for entry into final high-income product markets generally creates insuperable barriers to SME exporters and there is abundant evidence that they lead to the exclusion of SME suppliers, many of whom lack the education and skills required to consistently document and meet process and product standards required by global buyers (Kaplinsky and Morris, 2018).

In the face of these obstacles, and in the context of the flexibility of SMEs and the external economies arising from participation in industrial clusters, various sets of policy support may enable them to overcome these barriers to exports to high-income markets. Support may be provided directly by government (national and local), by civil society institutions (local and international), by collective action by cluster firms and of course through a combination of these three forms of support.

Beyond the capacity to meet the requirements of these markets is the related challenge of market entry. Unlike the decades before trade liberalisation, market entry is increasingly governed by private and civil society actors rather than by tariffs and quotas. One possible entry point into these final markets is through participation in governed GVCs which solves many of these problems. It promotes entry into final markets, it reduces the needs for market intelligence and it provides support for skills development and certification. In some cases, meeting these standards has been an important conduit for upgrading by SMEs, including in Africa's fruit, horticulture and flower sectors and in the apparel and footwear sector (Kaplinsky and Morris, 2018). However, for the reasons outlined earlier, involvement in these GVCs is not easy for SMEs to achieve, particularly not as standalone producers. Hence, the role of enterprise and cluster support should thus be to simultaneously *lean on* lead firms in GVCs to draw on SME suppliers, to assist SMEs to develop the skills and capabilities required by these lead firms and to assist SMEs to combine their efforts to produce to the scale and standards required by lead firms. Realistically, possible roles for SMEs in these chains is probably limited to second- and third-tier suppliers to the large TNC firms, where volumes are limited, technological and skill barriers are lower and certification is less prevalent.

Another possible entry point into high-income markets is to target niche markets, such as arts, crafts and jewellery. Many of these niches involve small volumes, and market entry is intermediated by NGOs. It is commonly thought that these are high-margin markets, but this is not always the case. For example, a small handicraft enterprise in South Africa targeted high-income niche markets using Fair Trade certification. However, it found that the transaction costs involved in meeting these standards cut too deeply into its profit margins to make it sustainable (Kaplinsky and Morris, 2018).

It is also possible for SMEs to sell directly into high-income markets without the involvement of foreign intermediaries, either through their direct action or by drawing on domestic buyers who onsell to external markets. But in these cases, there are a number of scale barriers which will need to be surmounted. In the case of Italian industrial clusters, minimum scale requirements were met by individual SMEs cooperating to sell under a common brand name. Another barrier is market intelligence which can often be a costly exercise; even occasional visits to

⁶Not all high-income markets are in high-income economies, and conversely, not all low-income markets are in emerging economies. Although it is the character of the market rather than the location of the market which determines the organisation of the value chains and the role played by SMEs, for ease of treatment we assume an identity between market location and market character.

⁷For example, among other requirements the Forestry Stewardship Council (FSC) standard precludes logging with 3 days of rain, requires that certain chemicals are not used in processing and that the rights of indigenous people are respected. Final certification requires a chain of custody evidencing conformance to standards along all links in the chain.

overseas markets may be beyond the reach of individual small firms. Similarly, branding and other marketing instruments such as advertising may have minimum costs. Further, insofar as final markets require certification (including, for example, with regard to Fair Trade accreditation), individual small firms may not have the financial resources to meet these requirements. An additional scale barrier arises with respect to attracting input suppliers whose presence requires minimum volumes of purchase.

In all these cases, the scale barriers can be overcome by a combination of joint action by cluster members, often with support provided by governments and NGOs. As observed earlier, it is this sort of collective action which enabled the *Third Italy* industrial districts to dominate global markets for many years despite the small size of producing enterprises. These Italian enterprises were supported by local governments nuanced to local conditions rather than by distant central government institutions. But each case is contextually specific and there is no intrinsic reason why NGOs, aid agencies or central governments too cannot support the development of collective efficiency by African clusters of SMEs.

However, it appears that what really matters in cluster upgrading is the convergence of GVC governance and the mode of organisation of interfirm linkages. Collective efficiency impacts differ by sector and in terms of type of upgrading possibilities. Process and product upgrading is much easier to attain whilst functional upgrading (that is, moving to a different link in the chain such as marketing or design) is most often retarded by lead firm governance (Giuliani et al., 2005). Focusing only on a cluster's *internal* collective efficiency dynamics is insufficient. Hence, external linkages (GVC lead firms and institutional support) play a central role in the success of upgrading activities in firms within clusters (Pietrobelli, 2007). Hence, a major policy challenge is generating policy to link GVC supply chain development and cluster support programs to meet standards and raise firm-level competitiveness.

4.2. SME Exports to Low-income Extra-regional Markets

In many respects, low-income markets are a mirror image of high-income markets. Critically, they are far less standard and regulations intensive and hence the role played by lead firms governing value chains is less significant. This removes some important barriers confronting SMEs, particularly with respect to certification and the related skill obstacles to market entry. For example, when Gabon's timber exports switched from the European Union to China, the requirements placed on producers to meet environmental standards were largely removed; a similar process was observed in the case of Thailand exports of animal feed (Kaplinsky et al., 2011). Low-income markets are not only less certification intensive, but also less sensitive to product quality; price is the dominant competitive attribute in these markets. These market characteristics play to the strength of many SMEs who often have much lower costs than their large-scale competitors (although they produce products of inferior quality).

However, despite lower standards the critical challenge confronting SME exports to low-income markets arises with regard to market entry. As observed earlier, in the case of high-income markets, market entry tends to be intermediated by lead firms governing GVCs, buyers located in external markets or by NGOs. These chain governors also generally engage in long-term relationships with suppliers, and in some cases provide support for the upgrading of capabilities in SME suppliers. By contrast, exports to emerging economies tend to occur on an arms-length basis. There is little face-to-face contact, buyer-supplier relationships are either volatile or impersonal and already existing suppliers in that region have a comparative advantage.

Two major marketing conduits dominate exports by African SMEs to regional markets. The first are local buyers aggregating volumes for export, and foreign buyers visiting the producing economy. The second market conduit is through African expatriates living abroad or by producers making periodic visits to final markets. For example, there are a large number of African citizens resident in China and involved in import-export links between China and Africa. The focus of both of these sets of market intermediaries tends to be on price performance and margins to SMEs producers can consequently be squeezed. Little or no support is provided by buyers for supplier upgrading.

African governments, NGOs and aid agencies have a lesser role to play in facilitating SME exports to low-income markets than to high-income markets. Much of this trade is market driven, and occurs on a small scale. However, the scale of these exports is highly dependent on logistics and transport links. Traditionally, shipping and air routes were directed northwards rather than southwards, and although there has been a massive shift in recent years (for example, Ethiopian Airlines now has 34 flights a week to China), there is scope for further improvement, particularly with respect to smaller African economies and relatively minor cities in China.

4.3. SME Exports to Regional Formal Markets

Regional low-income markets provide a major opportunity for the expansion of SME exports, especially through growing RVCs. These opportunities arise partly as a consequence of the low preference for quality and certification in these final markets, and partly because demand characteristics are often similar in the exporting and importing economies, providing fewer demands for market intelligence and product adaptation. Moreover, there are often existing connections between buyers and suppliers within the region that can be leveraged. An additional advantage promoting intraregional trade is that family and ethnic ties often span national borders.

However, considered in comparative perspective, intraregional African trade is lower than in other regions of the global economy (excluding South Asia), and is particularly marked for Middle, Northern and West Africa (Table 7). This is a function of a series of obstacles which

Table 7 | Share of intraregional trade in total external trade (%)

	1995	2000	2005	2010	2016
Developing economies: Africa	12.0	9.3	9.4	13.8	17.7
Developing economies: Eastern Africa	11.7	12.3	16.4	13.6	16.1
Developing economies: Middle Africa	1.4	0.9	0.8	2.0	1.5
Developing economies: Northern Africa	4.6	2.6	2.9	3.8	5.9
Developing economies: Southern Africa	7.5	3.0	2.5	14.8	15.2
Developing economies: Western Africa	9.5	9.3	9.6	7.6	10.7
Southern African Development Community	14.7	11.9	10.8	18.0	20.6
Developing economies: Eastern Asia	29.8	28.3	32.1	30.8	30.6
Developing economies: Southern Asia	5.4	4.6	6.6	8.8	9.2
Developing economies: South-Eastern Asia	24.9	23.0	25.3	25.0	24.2
Developed economies: America	35.9	39.6	40.6	32.4	30.6
Developed economies: Europe	66.3	71.6	71.8	69.0	66.9

Source: World Development Indicators. <http://wdi.worldbank.org> (accessed September 20, 2018).

need to be addressed at the national level, rather than at the firm or cluster level. Inter-country infrastructure is often poor (many African countries are very large) and trade preferences such as African Growth and Opportunity Act (with the United States) and Everything but Arms (with the European Union) have historically been directed at external high-income markets rather than neighbouring economies. Moreover, at-the-border trade impediments such as bureaucracy and corrupt customs officials have tended to be more evidenced with regard to intraregional trade than in trade with external regions.

Three recent developments have begun to have a positive impact on African intra-regional trade. The first has been the growth of African retail chains and RVCs spreading across national boundaries. South African supermarket chains have spread over Southern, East and West Africa. Four supermarket chains (Shoprite, Pick n Pay, Spar, Massmart) had 554 stores outside of South Africa by 2016. These stores are still mainly supplied with product from South Africa, although local supply is steadily increasing. Regional governments are pressurising the supermarket giants to expand domestic supply from local firms and farms. The expansion of these supermarket chains into the rest of Africa also creates the potential for regional supplier upgrading, as well as regionally supplying the South African market (Kaplan and Morris, 2016).

The second development is that retail apparel chains in South Africa creating RVCs by seeking supply from individual and clusters of apparel firms operating from other Southern Africa countries. Since 2007 a cluster of around 24 apparel firms operating from a town (Mapoetse) in Lesotho are successfully exporting into the South African market (Morris and Staritz, 2016). Likewise, a small cluster of apparel firms in Madagascar owned by a large Mauritian lead firm also work in coordination with their lead firm to supply South African upper market segment buyers (Morris et al., 2016).

The third is the growing recognition by African governments that there is considerable scope to expand intraregional trade. This is reflected in a series of regional trade agreements known as regional economic communities (RECs): Southern African Development Community (SADC), East African Community (EAC), Common Market for Eastern and Southern Africa (COMESA), Economic Community of West African States, Economic Community of Central African States, Intergovernmental Authority on Development, Arab Maghreb Union and Community of Sahel-Saharan States. However, they tended to overlap as some countries were members of more than one REC and were committed to joining more than one Customs Union which obstructed rather than facilitated African regional integration. To deal with this SADC, EAC and COMESA launched negotiations to create a Tri-Partite Free Trade Agreement signed in 2015 and built on three pillars of industrial development, infrastructure development and market integration. Subsequent to this the African Union sought to create a continent-wide free trade area. This has resulted in the African Continental Free Trade Area launched on the March 21, 2018, at a Summit of the African Union, in Kigali, Rwanda.

The implications of these are the following: When trying to expand SME exports to regional formal markets, leading economic hubs such as South Africa, Kenya and Ghana which spill over into local markets are important sources of trade dynamism, including for SMEs. These dynamic regional economic hubs play a crucial role in extending the scope of regional market opportunities and expanding the reach of local firms and production units from lower-cost bases within the region. Many of their large firms expand into the region, and not only draw in their domestic suppliers, but also use suppliers from elsewhere in the region. This provides learning opportunities for upgrading of SME firms locked into these RVCs (Barrientos et al., 2016; Pickles et al., 2016; Morris et al., 2016). Many smaller country governments are, however, cautious about the spread of such economic hubs as they fear opening up regional markets to free trade will allow stronger economies in the region to flood local markets and undermine their own more fragile SME producers. The appropriate policy answer is not to fall back on protectionism but rather to expand learning opportunities, skills development and upgrading of local managerial capabilities as regional integration takes off. The growth of RVCs and expansion of apparel exports from Lesotho, Swaziland and Madagascar into the South African market is a good example of the positive role such economic hubs can play in expanding regional markets and production opportunities in smaller regional economies (Morris et al., 2016).

Good regional infrastructure is of crucial importance and oils frictionless trade of inputs and outputs within the region. Poorly maintained hard infrastructure and cumbersome soft infrastructure (regulatory frameworks) inhibit the ability of firms to take advantage of regional market and linkage opportunities. Hence, regional initiatives to upgrade infrastructure and create common regulatory frameworks across

the region are fundamental. Establishing knowledge-intensive agencies (laboratories, standards testing facilities, etc.) with regional reach and scope assists firms to enter and sustain their place in RVCs. Finally, regional governments have a critical role to play in coordinating industrial policy which takes account of value chain dynamics and allows sectors to flourish, regional linkages to develop and firms to achieve collective efficiency.

4.4. SME Exports to Regional Informal Markets

As observed earlier, the overwhelming share of non-agricultural employment in Africa is in the informal sector. However, the predominant policy focus—including with respect to export expansion—is on the formal sector. The consequence is that a large volume of intraregional trade in Africa conducted by the informal sector occurs under the measurement of economic activity and under the policy radar in virtually all African economies. One estimate is that the incomes of more than 40% of Africa's population are in part earned through this informal cross-border trade (Brenton and Soprano, 2018). In the case of intra-SADC trade, it is estimated that the informal sector accounts for between 30% and 40% of total exports, valued at more than \$30 billion (Makoche Kanwa, 2012). Because much of this trade involves small-scale and low-income producers selling to relatively low-income consumers, this trade plays an important role in inclusive growth pathways.

As most of this trade is hidden and undertaken on an informal basis by very small-scale traders and producers, the policy challenges to increase the extent of this trade and to maximise developmental spillovers are limited. In some respects the best policy for the state is to retreat from over-regulation and control. Nevertheless, there are identifiable policy interventions which might make a material positive difference to the nature, extent and spillovers from informal sector cross-border trade:

Brenton and Soprano (2018) offer four areas for policy response:

- In the first instance, governments need to recognise the significance and impacts of this trade and to respond appropriately to its character and progress.
- The rules and regulations affecting this trade need to be simplified and made transparent.
- Assistance needs to be provided to small-scale traders to reduce the negative impact of institutional and legal structures. For example, small traders are more vulnerable to extortion by customs officials than are large firms.
- The important role played by women and the disadvantages which they face in informalised cross-border trade need to be explicitly addressed, not just as a normative concern for policy, but because of the key role which they play in exports.

To this list we can add the following concerns. First, much of this trade occurs through the iterant crossing of borders by informal sector traders, often without passing through any checking of identity documents. Related to this, traders often have family and ethnic links which span national borders. Hence, an insight into the roles played by these traders, and the extent to which policies affect them adversely or positively is an important area for policy concern. But because so little is known about the nature of these links, there is a particularly important knowledge gap which needs to be filled in assessing the significance of these issues.

Second, this trade is affected heavily by the nature and quality of infrastructure, particularly transport. This has a double-sided impact on informal sector trade. On the one hand, a well-functioning infrastructure system facilitates these cross-border flows. But, on the other hand, poor infrastructure inhibits the capacity of the formal sector to meet market demands, opening up the space for informal traders to operate. It is clearly inadvisable to recommend the maintenance of poor infrastructure. However, an understanding of the specific infrastructural needs of the informal traders (e.g., a cheap and effective bus network) will be an important arena for policy response.

Third, many of the products traded through these informal conduits are basic consumption items such as food products and low-cost apparel. Some of this is sourced from domestic producers in the country of origin of the traders but much is imported. Imports come through two channels: new products particularly from low-cost Asian economies (Table 8), and second-hand apparel sourced from high-income economies. The policy challenge is to increase the proportion of locally produced items in these trading baskets and/or to add value to these imported items. This poses a challenge to industrial and agricultural policies, including with respect to the sectoral targeting of interventions. But as in the case of the extent of informal sector trade, there is a yawning knowledge gap which requires to be filled before appropriate policy responses can be identified and implemented. The policy challenge is to identify a solution which serves both local formal apparel producers threatened by the import of second-hand clothing and takes into account the fact that such imports play an important role for informal regional traders.

Table 8 | The character of informal sector cross-border trade in Africa

Regions	Non-processed goods	Manufactured goods	Re-exports
Eastern Africa	Food and non-food stuff; livestock	Low-quality manufactured (e.g., apparel) and processed goods	Low-quality goods from Asia, including contrabands and counterfeit goods
West Africa	Food and non-food stuff; livestock		
Central Africa	Minerals, jewellery, forest products, food and non-food stuff		
Southern Africa	Handicrafts, food and non-food stuff	High-quality second-hand apparel	

Source: adapted from Afrika and Ajumbo (2012).

5. CONCLUSION

Given the low industrial base that Africa starts from, trade and industrialisation are integrally linked. Attempts to facilitate regional trade policies, whether they concern existing regional integration of current blocs or the continent as a single regional entity, cannot ignore the need for developing appropriate industrial policy. This is especially evident in respect of SME development. In other words what is required from African regional integration at any level is adopting an approach of developmental regionalism.

This consists of overcoming a number of policy challenges, addressing macro-economic policy, supply-based policies (firm and cluster upgrading) and market-focused policies (market access). First and foremost is the need to assist SMEs accessing external formal export markets. This takes the form of ensuring preferential trade access in order for SMEs to enter GVCs globally as well as RVCs within African regional blocs. Second, SMEs need supportive activities to become more competitive and ensure they remain, upgrade and grow in value chains. Essentially, this involves industrial support measures which develop managerial capabilities and skills levels of workers with SMEs, especially those able to generate collective efficiencies within clusters. Third, meeting value chain standards requires institutional capacity directly geared to providing knowledge-intensive skills to meet such requirements. Fourth, all firms whether formal or informal, small or large, require sound hard and soft infrastructure, good transport links and efficient logistics to ensure that goods and people are able to move smoothly across borders. Fifth, the need for regulatory harmonisation within African blocs as well as across regions to avoid creating unnecessary bureaucratic obstacles and free up impediments to trade. Sixth, tackling existing country protectionist policies on certain products (e.g., rice and poultry in Nigeria) by large economies which undermine regional integration and block regional trade access by smaller economies.

Currently regional growth and integration occurs in spite of, rather than because of, any regionally articulated policies and vision. If the current low level of SME development and nascent clusters are to grow and expand into viable and vibrant collectives of exporting SMEs, then a much grander vision of trade and industry integration has to be adopted and implemented.

CONFLICTS OF INTEREST

The authors declare that they have no conflicts of interest.

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