sectors, notably textiles and clothing, because of the challenges associated with moving towards taking control of some of the downstream functions within the textiles and clothing value chain, the traditional route of upgrading posited—from original equipment manufacturing (OEM) to original design manufacturing (ODM) and then original brand manufacturing (OBM) as described in Gereffi (1999)—has been replaced by other opportunities to increase the range of services offered to lead firms.

This is why the more recent distinction between a country that specialises in basic assembly and cut make and trim (CMT) (Tier 1) compared to another that is a full package supplier that takes control of the assembly of the product, including the sourcing of inputs as well as delivery to customers (Tier 2) is now made. However, the implication of these shifts in potential upgrading trajectories—the closing of some routes and opening of others—has not been adequately explored within the literature to date.

Movement by CMT producers into certain types of activities so as to become a full package supplier may generate powerful spillover effects. For example, the experience obtained with managing logistics could serve to attract similar basic activity functions of other industries. However, major questions remain as to the opportunities to functionally upgrade, as compared to previous decades, given the emergence of tiers of suppliers that specialise in particular functions.

Policy lessons for SSA's effective engagement with GVCs in the twenty-first century can be derived from the experiences of other exporters within the textiles and clothing sector. The most up-to-date summary of functional upgrading processes in the sector for Bangladesh is undertaken by Alam and Natsuda (2013). They find that most firms are engaged in what they term FOB-1 and FOB-2 production, which they describe as being analogous to the OEA, OEM and ODM descriptions and upgrading trajectory used within the GVC literature.[5] The terms are defined as follows:

- FOB-1 is a step above CMT production, whereby producers take responsibility for the sourcing of intermediate materials and production.
- FOB-2 includes the sourcing of intermediate materials and the undertaking of all levels of production and design.

Out of the 70 firms surveyed, 85% (56 firms) were involved with FOB-1 production, 6% (four firms) were involved with FOB-2 production and 9% (six firms) were involved with traditional CMT arrangements. They note that only four of the 70 firms surveyed offer finished products to retailers. This includes providing all necessary production material, including design and branding.

Although they do not distinguish between the end markets for these products they do note that, "most of the garment firms in Bangladesh are owned by domestic entrepreneurs who have limited capital, less experience, and little knowledge to carry out all necessary stages of production" (Alam and Natsuda 2013: 27). Competency in design was noted as a major barrier to entry by key informants in the sector. Overall, they conclude that although there is evidence of functional upgrading from CMT to FOB-1 production, the ability of firms to upgrade to FOB-2 is doubtful. They make reference to broad-based productive constraints, including weak infrastructure—a crucial component of logistics capabilities—as the reasons for this.

## 7.4 African GVC Case Studies

Despite the differences between the more recent quantitative additions to the GVC literature and that of the more qualitative wave of the 1990s, both perspectives recognise how global trade patterns have never been so interconnected. Moreover, that trading success within increasingly integrated global markets means entering and upgrading within GVCs. The ability of countries to do so depends on many of the policy measures applied at their borders, as noted by the traditional trade literature, as well as considerations related to institutions and economy geography. However, success also requires consideration of new issues and beyond the border measures.

It is recognised within the GVC literature that some upgrading processes may be easier to achieve within intra-regional value chains, precisely because these markets are less dominated by a few lead firms. Hence, supplying processed and branded chocolate may be more likely

for firms orientated towards intra-regional markets than more tightly controlled global markets, not only because of reduced competitiveness challenges but also because of similar tastes and cultural proximity. Barriers to entry within intra-regional markets may also be lower.

### 7.4.1 A Comparison of Kenya and Ethiopia

The high-value agriculture GVC has evolved in recent years to exhibit very similar tendencies to that of the textiles and clothing GVC. Because of this, and in view of recent developments in both sectors, this subsection presents a comparative analysis of recent upgrading processes in Kenya and Ethiopia. These are then subsequently related to the development of logistics capabilities and the ability to meet demanding "just-in-time" requirements.

Since the 2000's, around six UK retailers account for the direct sales route in the case of Kenya, and around half of these in recent years have been supplied directly by one major firm, a subsidiary of a major trans national corporation (TNC) (founded in 1750, originally as a trader and manufacturer of cotton). In recent years, because of continued growth in the sector, however, Kenyan leading firms have emerged. One of these recent entrants now ranks as one of the largest producers and exporters of fresh produce from Kenya and is among Kenya's top five flower exporters. Subsequently, the company has become part of a group that has expanded production into neighbouring countries such as Ethiopia and Ghana. In relation to the operations undertaken overseas, these have grown from production towards packaging and exporting, as well as into logistics, energy and general trading. This process of intra-sectoral upgrading has also begun to be replicated by other leading firms in the sector.

The available evidence suggests that Kenya is favoured as a preferred supplier mainly in view of its compliance infrastructure, a component of logistics capabilities (Table 7.1). In comparison, Ethiopia is viewed favourably in terms of cost. One aspect of this cost differential conferred to Ethiopia results from its status as a least developed country, compared to Kenya.

**Table 7.1** Country capabilities

| | Kenya | Ethiopia |
|---|---|---|
| Hectares | 3400 (in 2010) | 1600 (in 2010) |
| Main products | Range of products available: roses; other decorative flowers<br>High value rose products (geographical factor) | Roses ~ limited flower product |
| Main destinations | 66% UK; 17% Netherlands; 5% Germany; 12% other | 84% Netherlands; 8% Germany; 8% other |
| Strengths | Certification and trust in compliance infrastructure: business to business and retailer specific<br>Pool of skilled labour force<br>Ten-year corporate income tax holiday<br>Exemption from VAT and customs import duty on inputs<br>Business support services, including industry associations<br>Political stability | Cost competitive; incentives provided to investors<br>Cheap labour force<br>Ease of doing business<br>Tax holiday for five years; duty free import of input materials<br>Credit and finance available |
| Weaknesses | Perceptions regarding pesticide residue issues in the past (e.g., MRL)<br>Perceptions regarding labour standard and rights issues, e.g., minimum wage legislation<br>Difficult to start a business and register property; complex land management and administration<br>Taxes are problematic with poor co-ordination among government agencies<br>Labour is no longer low cost | Weak compliance infrastructure; delisted from some standards compliance (e.g., Sedex)<br>Weak post-harvest technologies<br>Labour standard and rights issues, e.g., minimum wage legislation<br>Air freight dictated by government<br>Lack of trade promotion support |
| Trade policy | Uncertainty regarding the EU-EPA negotiations was problematic and costs were borne due to a failure to conclude negotiations in advance of the deadline set by the EC<br>Market access has been secured | LDC status and security of tariff rent available in EU market.<br>Willingness to work with buyers and industry representatives, e.g. CBI Netherlands |

Source: Adapted from Rikken (2011 and 2012)

#### 7.4.1.1 Upgrading Opportunities, Including Multi-Chain

The range of upgrading opportunities for producers in the modern agricultural sector are similar to those available to new entrants into the textiles and clothing GVC. A form of functional upgrading could entail sales on the domestic market. Gaining control of logistics and supplying retailers with a flower product may be considered broadly comparable to movement from FOB-1 to FOB-2 suppliers in the textiles and clothing GVC (Keane 2017). A form of upgrading entails moving from supplying fresh cut flowers, towards the supply of complete bouquets and flower "product".

There is evidence of Kenyan cut flower firms moving towards a position of a full package supplier, with responsibility for sourcing all inputs, as in the case of a more relational type of GVC governance (Keane 2013). In this respect, it is fairly safe to say that Kenya is an FOB-2 type supplier. In comparison, Ethiopia remains at the FOB-1 stage of production. It mainly supplies fresh cut flowers (roses) mainly to Dutch auction houses; some supply is destined for UK retailers.

As described by Keane (2017), the comparison of GVC engagement in the cut flower GVC in Kenya and Ethiopia suggests there is evidence of a type of East African "flying geese" in action. This is taking place as investors in Kenya begin activities in Ethiopia, which is a lower cost producer of cut flowers. Ethiopia has been inserted into the cut flower GVC through a strong FDI-led process, with a specific focus on the supply of cut flowers to Dutch auction houses. It has exhibited an impressive performance to date in relation to the volume of cut flowers exported. There is evidence of some functions, notably logistics, being handled by the Kenyan firm.

The emergence of tiers of suppliers therefore includes some Kenyan lead firms, which also act as intermediaries, controlling production and supply to retailers, including from Ethiopia—because they have developed the logistics capabilities to do so. These results are interesting in a number of respects because they represent an aspect of the multi-chain hypothesis that is under-explored in the literature—horizontal integration. The development of formidable logistics capabilities invariably underpins these recent trends.

The evolution of the cut flower GVC suggests that some Kenyan lead firms have extended their range of services undertaken within the sector

across a number of countries, including Ethiopia. As described by Keane (2017), this is essentially a form of intra-sectoral upgrading, which is not currently conceptualised within the GVC governance structures identified by Gereffi et al. (2005). Intra-sectoral upgrading induced through improvements in logistics capabilities has occurred even though functional upgrading in the conventional sense, into international services such as sales and marketing, has not been achieved.

### 7.4.2 Firms in Southern Africa[6]

Firms based within the South African Customs Union (SACU) are highly likely to be subject to major or severe customs and trade regulations compared to most other regions (Keane et al. 2010). As major and severe customs and trade regulatory barriers are experienced, the more likely it is that Southern African firms export on an intra-rather than an extra-regional basis (Keane 2015).

In the following sub-sections, the results of the econometric exercise undertaken by Keane (2015) are summarised. This analysis moves beyond trade cost considerations in order to explore the capabilities underpinning the choice of export markers. It explores indictors related to GVC participation. This includes a customs, trade and regulation dummy variable as a proxy for logistics capabilities. Despite the limitations inherent in the research methodology, which are reflective of a more general lack of information on GVC-related firm-level indicators, differences between firms trading products mostly on an intra- and extra-African basis have been identified, which arguably warrant further attention.

#### 7.4.2.1 Empirical Analysis

First, the results specifying $\gamma$ as a dichotomous outcome variable, coded as = 1 if SACU firms only supply the domestic market, are presented in Table 7.2. These results suggest older firms are less likely to supply domestic markets, as is the case for those that are foreign owned. Firms selecting the domestic market are also less likely to encounter major or severe customs and trade regulations—an obvious result. Although the effect of firm size is

**Table 7.2** Firms orientated to the domestic market

| | B | S.E. | Wald | Sig. | Odds ratio Exp (B) |
|---|---|---|---|---|---|
| Ownership dummy | −3.917 | 0.221 | 313.795 | 0.000** | 0.020 |
| Manager's experience (years) | 0.14 | 0.009 | 2.424 | 0.119 | 1.014 |
| Firm age (years) | −0.14 | 0.006 | 4.846 | 0.028** | 0.987 |
| Customs, trade regulations dummy | −5.69 | 0.315 | 3.271 | 0.071* | 0.566 |
| Labour regulations dummy | −0.141 | 0.302 | 0.219 | 0.639 | 0.868 |
| Workforce dummy | 0.327 | 0.243 | 1.802 | 0.179 | 1.386 |
| Size (no. of employees) | 0.000 | 0.000 | 5.659 | 0.17** | 1.000 |
| Formal training dummy | −0.261 | 0.192 | 1.848 | 0.174 | 0.770 |
| Constant | 4.066 | 0.262 | 241.451 | 0.000 | 58.308 |

Note: *N* = 1652. The labour regulations, customs/trade regulations and workforce regulations dummy variables take a value of 1 if firms report these policy and institutional variables to have either a severe or major (negative) effect on production. Goodness of fit indicators: Cox and Snell 0.281; Nagelkerke R Square 0.511

Source: World Bank Enterprise Surveys and UN Comtrade; Keane (2015)

* = significant at 10% level; ** = significant at 5% level

significant, its influence in terms of the odds ratio is ambiguous: it neither increases nor decreases the odds of firms selecting the domestic market.

### 7.4.2.2 Results: Intra- and Extra-Regional SACU Exporters

The potential differences between firms that export goods traded mainly on an intra- or extra-regional basis are explored. In order to do this we first specify $\gamma$ as a dichotomous outcome variable, coded as = 1 if SACU firms export mainly on an intra-regional basis. The results are presented in Table 7.3. The independent dichotomous variable is only coded 1 for those firms that produce products we definitely know are mainly supplied on an intra-regional basis (using our 50% threshold).

It is clear from the results presented in Table 7.3 that the policy/institutional barriers of customs/trade regulations and workforce regulations exert a significant influence (10 and 5% level, respectively) on the likelihood that a firm exports on an intra-regional basis. These results are easier to make sense of when we compare them to the results for extra-regional exporters. In Table 7.4 we specify $\gamma$ as a dichotomous outcome variable, coded as = 1 if SACU firms export predominantly on an extra-regional basis.

**Table 7.3** Results of logistic regression for intra-regional exporters

| | B | S.E. | Wald | Sig. | Odds ratio Exp(B) |
|---|---|---|---|---|---|
| Ownership dummy | 3.388 | 0.276 | 150.264 | 0.000** | 29.599 |
| Manager's experience (years) | −0.023 | 0.011 | 4.241 | 0.039** | 0.978 |
| Firm age (years) | 0.006 | 0.007 | 0.650 | 0.420 | 1.006 |
| Customs, trade regulations dummy | 0.651 | 0.346 | 3.533 | 0.060** | 1.917 |
| Labour regulations dummy | 0.390 | 0.338 | 1.330 | 0.249 | 1.477 |
| Workforce dummy | −0.913 | 0.319 | 8.206 | 0.004** | 0.401 |
| Size (no. of employees) | 0.000 | 0.000 | 0.124 | 0.725 | 1.000 |
| Formal training dummy | 0.287 | 0.223 | 1.650 | 0.199 | 1.332 |
| Constant | −4.261 | 0.309 | 190.130 | 0.000** | 0.014 |

Note: *N* = 1652. The labour regulations, customs/trade regulations, and workforce regulations dummy variables take a value of 1 if firms report these policy and institutional variables to have either a severe or major (negative) effect on production. Goodness of fit indicators: Cox and Snell 0.140; Nagelkerke R Square 0.349

Source: World Bank Enterprise Surveys and UN Comtrade; Keane (2015)

* = significant at 10% level; ** = significant at 5% level

**Table 7.4** Results of logistic regression for extra-regional exporters

| | B | S.E. | Wald | Sig. | Odds ratio Exp (B) |
|---|---|---|---|---|---|
| Ownership dummy | 4.161 | 0.529 | 61.848 | 0.000** | 64.115 |
| Manager's experience (years) | 0.022 | 0.013 | 2.981 | 0.084* | 1.022 |
| Firm age (years) | −0.015 | 0.011 | 1.958 | 0.162 | 0.985 |
| Customs, trade regulations dummy | −1.359 | 0.640 | 4.513 | 0.034** | 0.257 |
| Labour regulations dummy | 0.284 | 0.411 | 0.478 | 0.489 | 1.328 |
| Workforce dummy | 0.103 | 0.338 | 0.092 | 0.761 | 1.108 |
| Size (no. of employees) | 0.000 | 0.000 | 4.184 | 0.041** | 1.000 |
| Formal training dummy | 0.117 | 0.285 | 0.169 | 0.681 | 1.124 |
| Constant | −5.875 | 0.572 | 105.373 | 0.000** | 0.003 |

Note: *N* = 1652. The labour regulations, customs/trade regulations and workforce regulations dummy variables take a value of 1 if firms report these policy and institutional variables to have either a severe or major (negative) effect on production. Goodness of fit indicators: Cox and Snell 0.105; Nagelkerke R Square 0.365

Source: World Bank Enterprise Surveys and UN Comtrade; Keane (2015)

* = significant at 10% level; ** = significant at 5% level

It may be expected that firms which trade predominantly on intra- and extra-regional bases exhibit differences related to the indicators we use as proxies for GVC participation. However, what has been revealed through this analysis is how firms that export on an intra-regional basis are more likely to experience problematic customs, trade and regulatory barriers, which may reflect weak logistics capabilities. Moreover, firms are less likely to export on an extra-regional basis if these logistics capabilities are weak.

To some extent these results further substantiate the empirical findings of Keane et al. (2010). Although this analysis could be improved in a number of ways—for example, interaction terms could be introduced, as well as the use of panel data to explore whether firms begin exporting on an intra-regional basis—nonetheless, the results are suggestive of important differences in relation to logistics capabilities and the likelihood of exporting on an intra-regional basis within Southern Africa, which deserves further attention.

## 7.5 Concluding Remarks

Much of the current mainstream interpretation of the GVC discourse focuses on these aspects of trade costs, which are directly affected by the logistics sector, but much more limited attention is paid to the role of the logistics sector in terms of the development of producers' capabilities. This is an important omission that assumes a particular importance in view of the role of the logistics sector in relation to conventional value-adding processes. Through comparative case study analyses of firms in Eastern and Southern Africa, within archetypal GVCs such as the textiles and clothing and high-value agricultural sectors, this chapter demonstrates why this is an important omission.

The comparison of GVC engagement in the cut flower GVC in Kenya and Ethiopia provides some evidence of a type of East African "flying geese" in action. This is taking place as investors in Kenya begin activities in Ethiopia, which is a lower-cost producer. Ethiopia has been inserted into the cut flower GVC through a strong FDI-led process, with a specific focus on the supply of cut flowers to Dutch auction

houses. It has exhibited an impressive performance to date in relation to the volume of cut flowers exported. There is evidence of some functions, notably logistics, being handled by Kenyan firms. The evolution of the cut flower GVC suggests that some Kenyan lead firms have extended their range of services undertaken within the sector across a number of countries, including Ethiopia. This is essentially a form of intra-sectoral upgrading, which is not currently conceptualised within the GVC governance structures identified by Gereffi et al. (2005). Intra-sectoral upgrading has occurred, even though functional upgrading in the conventional sense into international services such as sales and marketing, has not been achieved (Keane 2017). With regards to firms in Southern Africa, the results of an econometric exercise undertaken by Keane (2015) to explore firm-level performance across different types of value chains reveal differences between firms' trading products mostly on an intra- and extra-African basis, which warrant further attention.

Through comparative GVC case study analysis, which draws on the upgrading experiences of producers in the cut flower GVC in East Africa and the available evidence for firms that trade on an intra- or extra-regional basis in Southern Africa, including across multiple markets, this chapter shows that weak logistics capabilities may reduce the ability of firms to service multiple markets and the upgrading opportunities which may result.

## Notes

1. Although there are three main types, the UNCTAD/Eora database has the most country coverage.
2. These results are presented in Shepherd (2016).
3. The World Bank's logistics performance index (LPI)—a weighted average of six indicators, and based on a survey of around 1000 logistics professionals—takes into account performance on trade and transport-related infrastructure, customs clearance, the ease of arranging competitively priced shipments, the ability to track and trace consignments, timeliness of delivery, and the competence and quality of logistics services.

4. See Pathikonda and Farole (2016).
5. This is derived from case study analysis of the automotive or electronics industry.
6. Adapted from Keane (2017) forthcoming.

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# 8

# The Importance of the Services Sector for Africa

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A. Adewole, J. J. Struthers (eds.), *Logistics and Global Value Chains in Africa*, Palgrave Studies of Sustainable Business in Africa,
https://doi.org/10.1007/978-3-319-77652-1_8

## 8.1 Introduction and Literature Review

This chapter focuses on the transport, communications and financial services sectors in Africa, reviewing the state of these sectors, as well as the policies that govern them at regional level. It also analyses the importance of these sub-sectors in development and assesses the various approaches adopted by governments to regulate these sectors.

### 8.1.1 The Importance of the Services Sector

Evidence from economic development worldwide shows that the growth of the services sector tends to go hand in hand with growth in gross domestic product: in richer economies, services tend to account for higher shares of economic activity (Economic Commission for Africa 2015a). Further, the emergence of global value chains reveals the close link between services and the creation of value in the exchange of intermediate products. The trade in value-added data recently developed by the Organization for Economic Co-operation and Development suggests that the value of trade in services, when taken from a value-added perspective, may be approaching half of world trade exports (45%) (Economic Commission for Africa 2015a, b). In addition, global value chains rely on well-functioning transport, logistics, finance, communication and other business and professional services to move goods and coordinate production along the value chain (Organization for Economic Co-operation and Development 2014).

The Economic Commission for Africa's *Economic Report on Africa 2015* states that,

> the emergence of services and the increased fragmentation of global value chains (into 'tasks') have the potential to substantially rebalance the 'old economy' distribution of comparative advantages based on natural endowments of developing countries. By creating a competitive advantage in a service tasks, countries can overcome traditional obstacles such as being a small market, being landlocked and being remote thanks to information and communication technologies (World Bank 2014a). Moreover, the fragmentation of production in global value chains and information and communication technology development open up opportunities for small

> and medium-sized enterprises to participate in the global economy by reducing the threshold and capital necessary to enter markets for intermediate goods and services (tasks). Within Africa, Kenya and Uganda are already well-known success stories in business and [information and communication technology] services exports.

In addition, the report notes that "inexpensive and good quality service inputs (domestic or foreign) can enhance competitiveness in agriculture, mining and manufacturing sectors. According to the [Organization for Economic Co-operation and Development], as much as 30 per cent of value-added of the manufacturing sector's exports is accounted for by services inputs."

#### 8.1.1.1 Services in Developing Countries

Services remain similarly important when the focus is turned to developing countries and least-developed countries only. In 2011, the services sector accounted for an average of 47% of gross domestic product in least-developed countries. Least-developed countries' commercial services exports more than doubled from USD 9 billion in 2005 to USD 22 billion in 2011, growing much faster over that period—at 138%—than total world commercial services exports—at 70% (International Trade Centre 2013). The United Nations Conference on Trade and Development (2013) points out that despite an 18% drop in global foreign direct investment (FDI) in 2012, the services sector was the least affected, and FDI inflows to least-developed countries hit a record high—an increase led by developing country investors. Similarly, United Nations Conference on Trade and Development (2017a, p. 21) points out that FDI in 2015 was concentrated in the services sector, with FDI stocks in services being valued at USD 16 trillion worldwide (compared to USD 10 trillion for manufacturing, primary commodities and unspecified sectors combined). Announced greenfield FDI projects destined for least-developed countries were concentrated in services, with the sector accounting for USD 32 billion of such investments out of a total of USD 44 billion across all sectors (Ibid., p. 83).[1]

Further, World Bank research shows that the services sector has become a dominant driver of economic growth in developing countries, delivering

both growth in gross domestic product and poverty reduction. The research shows that services growth has a strong poverty-reducing effect across 60 countries (including 29 in Africa, excluding North Africa). Indeed, between 1990 and 2010, growth in agriculture and services was found to be strongly associated with poverty reduction, while the growth of industry did not have a significant effect on reducing poverty (World Bank 2014a). A study focusing on Southeast Asia also shows that services have the strongest impact on poverty reduction in that region (Warr 2002).

#### 8.1.1.2 The Service Sector in Africa

Evidence on Africa suggests that services play a similarly important role there as elsewhere in the world. Table 8.1 shows evidence on the correlation between the growth in services value-added and growth in value-added of other sectors, as well as that of gross domestic product and gross domestic product per capita.

**Table 8.1** Correlations between growth in services value-added, growth in value-added of other sectors, growth in gross domestic product and gross domestic product per capita growth—sample of 53 African countries, 2000–2012

| Correlations | Growth in services value-added | Growth in industry value-added | Growth in manufacturing value-added | Growth in agriculture value-added |
|---|---|---|---|---|
| **Growth in gross domestic product** | 0.86 | 0.70 | 0.81 | 0.90 |
| **Growth in gross domestic product per capita** | 0.87 | 0.67 | 0.80 | 0.86 |
| **Growth in services value-added** | | 0.52 | 0.85 | 0.68 |

Source: Economic Commission for Africa calculations based on World Bank (2014c)

Data on growth in gross domestic product between 2000 and 2012 are available for 49 African countries. Data on growth in services value-added between 2000 and 2012 are calculated for 33 African countries. Data on growth in manufacturing value-added between 2000 and 2012 are calculated for 31 African countries. Data on growth in industry value-added between 2000 and 2012 are calculated for 32 African countries. Data on growth in agriculture value-added between 2000 and 2012 are calculated for 34 African countries

Indeed, in 2013 the services sector was the main contributor to gross domestic product in the majority of African countries—35 out of 54.

Across Africa, value added in services has grown more than value added in manufacturing, industry or agriculture over 2000–2012. Such correlation is higher than that between growth in manufacturing or industry value-added and growth in gross domestic product. Value added in services in Africa has seen a larger growth than value added in manufacturing, industry or agriculture over 2000–2012. Moreover, data show a strong correlation between growth in services value added and growth in gross domestic product for African countries over 2000–2012, at 0.85. This correlation is higher than those between growth in manufacturing or industry value added and growth in gross domestic product (respectively 0.70 and 0.81) (Economic Commission for Africa 2015a, b). This might be due to the fact that the services sector is employment-intensive and points to the potential of services to drive the continent's growth.[2] Only the correlation between growth in agriculture value added and growth in gross domestic product is stronger than the one for services, at 0.90: this might be due to the fact that agriculture still employs the majority of people in Africa.[3]

The correlation between growth in services value-added and growth in manufacturing value-added across African countries over 2000–2012 is also exceptionally strong, at 0.85, possibly pointing to the synergies between the two sectors (Economic Commission for Africa 2015a). The fact that value-added in services and in manufacturing move together suggests that services are necessary to support other sectors of the economy.

Services is also a leading driver of FDI into Africa: the share of FDI going into services in Africa reached 40% in 2012 compared to 24% in 2011 (United Nations Conference on Trade and Development 2013). According to Ernst and Young, in 2007 extractive industries represented 8% of FDI projects and 26% of capital invested in Africa; in 2012, they accounted for a mere 2% of projects and 12% of capital. In comparison, services accounted for 70% of FDI projects in 2012 (up from 45% in 2007), and manufacturing activities accounted for 43% of capital invested in 2012 (up from 22% in 2007). Other sectors where there has been a noticeable shift include information and communication technology (14%, up from 8%), financial services (13%, up from 6% in the previous year), and education. By 2016, the vast majority of announced greenfield

FDI projects destined for Africa (USD 71 billion out of USD 94 billion) were in the services sector (United Nations Conference on Trade and Development 2017a, p. 45).

Economic Commission for Africa (ECA) research has also found that the presence of a thriving services sector is essential for attracting investors into African businesses as it allows them to source the support services they need locally. The absence or lack of competitiveness of vital services such as banking, insurance, business support, telecommunications and transport can discourage investors from pursuing a business opportunity in a country.

#### 8.1.1.3 Financial and Infrastructure Services

*Economic Report on Africa 2015* summarises the evidence on the importance of financial and infrastructure services for development as follows.

> Infrastructure services such as energy, telecommunications and transportation are essential for firms to be competitive; financial services facilitate transactions and provide access to credit for investment; construction services are essential for business development; and legal and accountancy services are vital components of a thriving business environment.

In Africa, deficits of infrastructure have a clear impact on African competitiveness and this has been found to undermine growth by as much as 2 percentage points and reduce productivity by as much as 40% (African Union 2014; Foster and Briceña-Garmendia (eds.) 2010). The lack of adequate transport infrastructure undoubtedly reduces Africa's ability to participate in the world economy. Most African countries also find it hard to compete in the world market owing to inadequate, inefficient and very expensive telecommunications services (World Trade Organization 2013). High transport costs in West Africa present a greater barrier to trade than regional import tariffs (World Bank 2008). It has been reported that the key factors that can increase operating costs for international firms include transport and communications infrastructure services. Concerted action to raise the average performance of countries in these sectors to half the level of best practice could increase global gross domestic product by almost 5%, six times more than would result from removing all remaining import tariffs

(World Economic Forum 2013a). There is immense potential for increasing global trade, and thereby economic growth, by reducing supply chain barriers. The global transport and logistics sector plays a key role in releasing this potential and Africa is no exception (World Economic Forum 2013b).

In the financial sector, "African countries cite lack of access to finance as a major obstacle to business development, the provision of financial services on the continent is particularly important for the future growth of African businesses" (Beck and Cull 2014; Pesce and Abdallah 2014; Economic Commission for Africa 2015a, b; Economic Commission for Africa, World Trade Organization and Organization for Economic Co-operation and Development 2013).

Moreover, studies since 2009 have also demonstrated that information and communication technologies, including mobile phone development, have contributed significantly to economic growth in Africa in recent years, in particular by promoting financial inclusion through mobile financial services (Andrianaivo and Kpodar 2011).

As such, the infrastructure and financial services sectors appear to play an important role in Africa's development.

## 8.2 Overview of Trends and Patterns in the Service Sector in Africa

The following bullet points give a summary of the trends in Africa's service sector. This is then followed by more detailed material on these trends and patterns.

- Services are an increasingly important component of African economies and trade. In recent years, Africa's exports of computer and information services, financial and insurance services, have seen strong growth. Country experience, however, shows that growth in such services does not always support local firms.
- Over the past decade, Africa's exports of services have grown significantly in absolute value.

- Services are an important component of Africa's exports.
- Services have an essential role in Africa's economic transformation: they are key inputs to most other businesses, make a direct contribution to gross domestic product and job creation, attract investments into local businesses and are a magnet for FDI.

In 2012, services were the sector with the largest contribution to gross domestic product in 35 out of 53 African countries. Seychelles, Djibouti and Mauritius topped the list of African countries with the highest share of services in gross domestic product. Further, over the past two decades, services were the fastest growing sector in Africa: from 1995 to 2011, they accounted for 62% of cumulative growth in gross domestic product per capita on the continent, compared to 24% for industry and 13% for agriculture (World Bank 2014b).

As shown in Fig. 8.1, Africa's growth in services output over 2000–2012 was higher than the world average and faster than that of several other regions (Fig. 8.2).

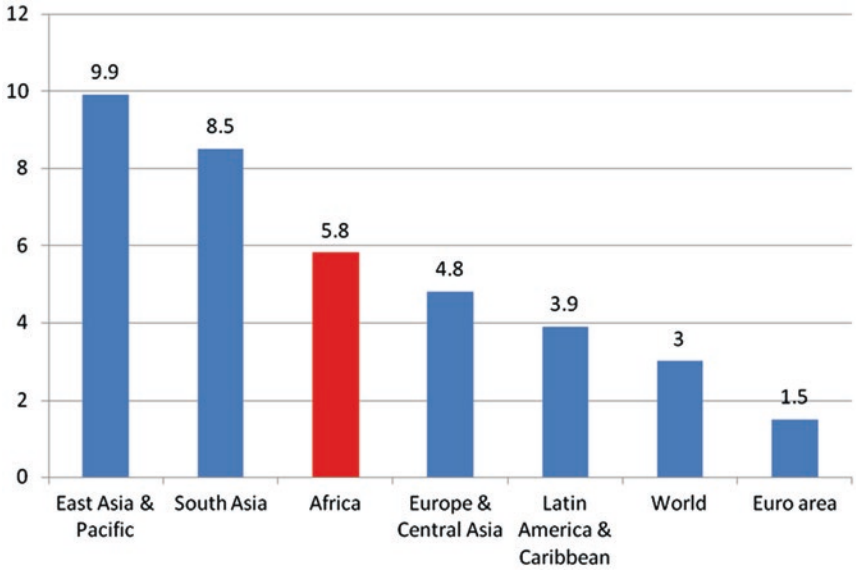


**Fig. 8.1** Average annual growth in services output by regions 2000–2012. (Source: Authors' calculations based on World Bank (2014c))

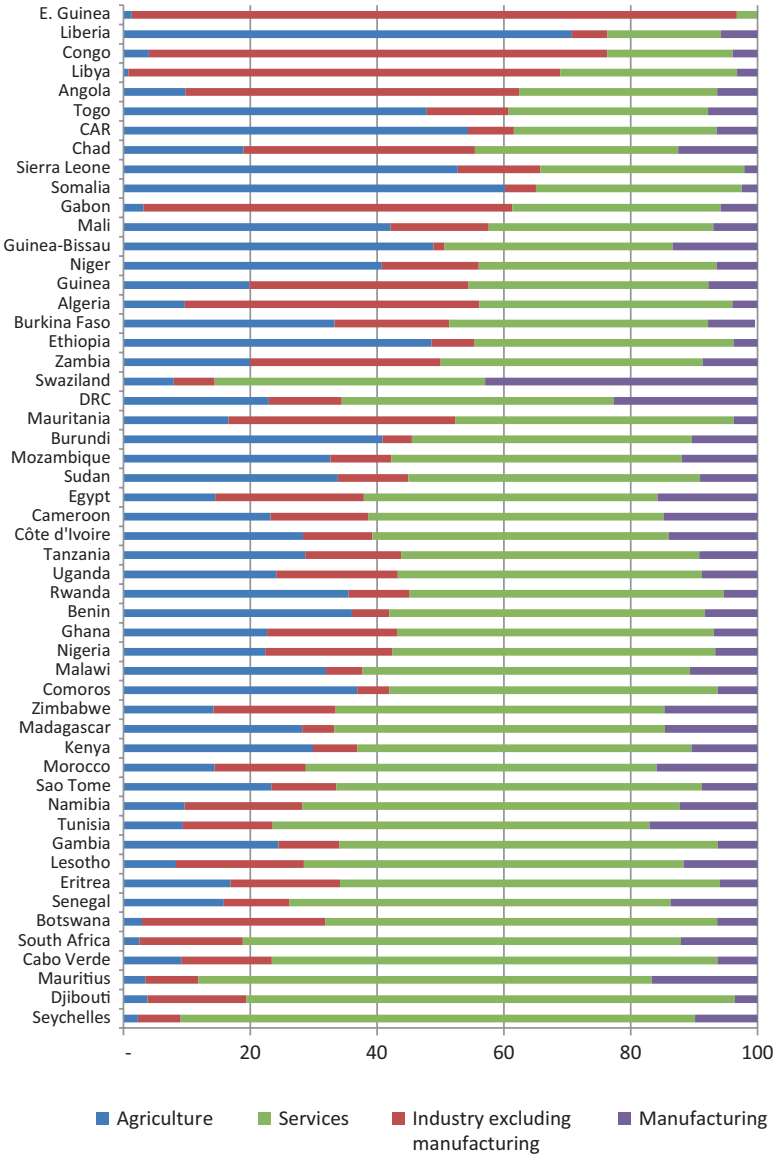


**Fig. 8.2** Contribution of the main sectors to gross domestic product across African countries, 2013, in increasing order of services contribution. (Source: Authors' calculations based on African Development Bank, African Union Commission and Economic Commission for Africa (2014))

Services offer an option for economic transformation for countries, such as small island states (e.g., Seychelles, where services value-added was 81% of gross domestic product, or Cabo Verde with 70%) or small landlocked states (e.g., Botswana or Lesotho, where services value-added was 62% and 60% respectively of gross domestic product), for which manufacturing might not be the best development option (World Bank 2014c; Economic Commission for Africa 2015a). It is interesting to note that African countries with a relatively high share of services in gross domestic product tend to be resource-poor: the correlation between the World Bank natural resources rents index and the share of services in gross domestic product is strong and negative, at −0.73.[4]

Equatorial Guinea, Ethiopia and Liberia were the African countries that saw the highest growth in services value-added over 2009–2012, respectively 31%, 14% and 11%. In Equatorial Guinea, services have grown significantly to support the booming oil and mining sectors and driven by government investments. The government focused on improving transport, electricity infrastructure and public buildings (hospitals and schools) as part of its National Economic and Social Development Plan 2008–2012 (PNDES).

In Ethiopia, the service sector was estimated to have grown by 9.9% in 2012–2013, mainly driven by expansion in wholesale and retail trade (34.4%), transport and communications (17.1%), hotels and tourism (15.4%), and other community services (African Development Bank, Organization for Economic Co-operation and Development and United Nations Development Programme 2014).

In Liberia, the services sector experienced around 9% growth in 2013 and contributes around 44% of gross domestic product. Its main activities include trade and hotels, government services, real estate, construction, and transport and communication (African Development Bank, Organization for Economic Co-operation and Development and United Nations Development Programme 2014).

In Nigeria, Africa's largest economy, telecommunications and ICT contributed 10.4% of growth in gross domestic product between 2010 and 2013. Other business services contributed 8.7%, finance and insurance 7.5%, entertainment and music 3.7%, and professional and technical services 2.6%. Overall, services contributed to more than 50% of Nigeria's growth in gross domestic product between 2010 and 2013

(McKinsey Global Institute 2014).[5] This was much more than the contribution from the resources sector, contradicting the stereotype that Nigeria's economy is mainly driven by its oil.

Regarding Africa's trade in services, in 2013 all African countries for which data are available exported services. Africa's exports of services increased from USD 11.5 billion in 1980 to USD 32.7 billion in 2002 and USD 89.5 billion in 2012, a remarkable and continuous rise (International Trade Centre 2014; Economic Commission for Africa 2015a, b). This shows that Africa's services exports are competitive on international markets. If we were to assume that the international market for services is competitive, a marginal increase in the productivity of Africa's services sector would allow Africa to significantly increase its share in the global services market.

Figure 8.3 shows the breakdown of Africa's services exports by sector. Other business services, one of the fastest growing sectors of world trade today, which includes for example professional, technical and information technology-enabled business-to-business outsourcing services, was also a relatively large share of Africa's services exports in 2013 (6.3%).

These data reflect the importance of tourism for African economies, which accounts for 40% of Africa's services exports. Over 2000–2010, tourism receipts in Africa increased almost threefold.[6] Despite these encouraging numbers, tourism on the continent remains largely below potential due to constraints such as transport bottlenecks, insecurity, low quality of services, lack of investments, expensive aviation and scarce and

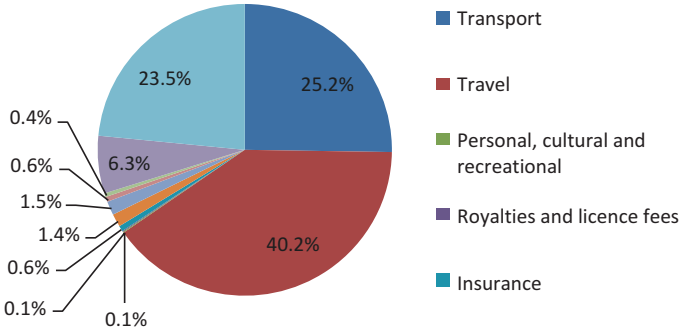


**Fig. 8.3** Africa's exports of services by category, 2013. (Source: Authors' calculations based on International Trade Centre (2014))

costly accommodation in capital cities. Increases in aviation into Africa appear to have been a key factor behind this increase in tourism receipts. Over the same period (2000–2010), the number of air passengers arriving into Africa doubled over the period, reaching 62.6 million people in 2010.[7] South Africa, Egypt, Ethiopia, Morocco, Nigeria and Algeria have particularly strong aviation sectors: airlines from these countries carried between 4 million (Algeria) and 17 million (South Africa) passengers in 2012.[8] South Africa, Ethiopia, Egypt and Kenya also carried the largest amounts of freight in 2012. Despite these successes, flying across Africa remains much more expensive than flying across other world regions (*The Economist* 2013). All of this highlights the importance to the continent of a strong aviation sector.

As shown in Fig. 8.4, the composition of Africa's exports of services changed significantly over recent decades. Between 2002 and 2012 the shares of travel, transport, construction, insurance, financial services, computer and information and royalties and license fees increased within Africa's exports of services.

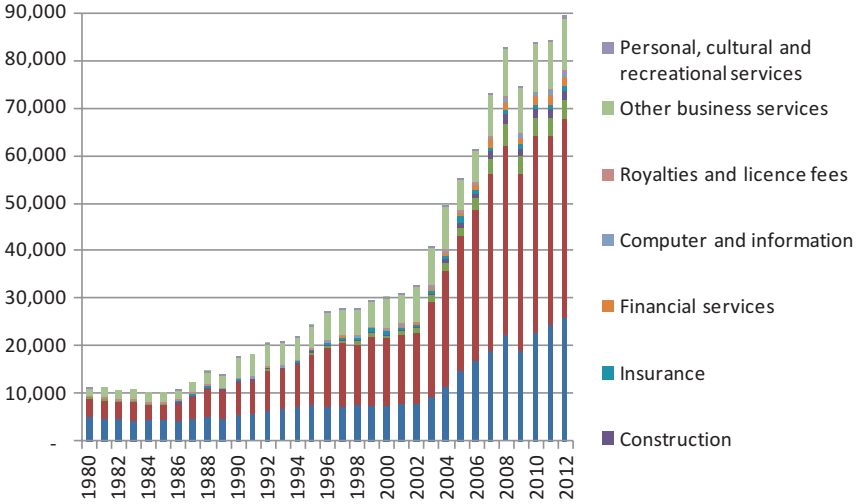


**Fig. 8.4** Africa's exports of commercial services by category in absolute value, 1980–2012 (USD millions). (Source: Authors' calculations based on International Trade Centre (2014))