



3rd EU-Africa Business Forum

September 28-29, 2009

Nairobi, Kenya

Discussion Paper on Entrepreneurship & SMEs

(draft version)



Introduction

The Breakout Session on Entrepreneurship & SMEs as part of the EU-Africa Business Forum provides an opportunity for the delegates to discuss and debate a number of important topics, action steps and initiatives relative to the improvement of Entrepreneurship & SMEs in Africa. This is a crucial area in improving economic development in Africa and implementing government pro-poor policies successfully, as well as achieving the UN Millennium Development Goals and the gradual integration of African economies into the global economy. One of the first priorities of the European Commission co-operation policy in Africa is support in building sustainable and robust economies.

Four main topics have been selected for discussion:

- ✓ On the Enabling Environment for Entrepreneurship and SMEs: Which is the main regulatory reform that would improve the status of SMEs in global markets?
- ✓ On access to financial and non-financial services: **How can subsidy/guarantee be best used in increasing the demand and supply of services to SMEs?**
- ✓ On the Formation of Business Linkages: **What can best support SMEs to become more proactive in forming business linkages horizontally and vertically?**
- ✓ On the role of intermediary organizations: **Which 3 activities by intermediary organizations best support SMEs in upgrading their productivity and business linkages?**

These four topics are set out below in this discussion paper.

The Session also provides an opportunity to review the recommendations in four key areas with regard to Entrepreneurship & SMEs, which were agreed at **the Second Business Forum** held in Accra, Ghana from 21 - 22 June 2007. These four



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recommendations are set out in Annex 1 below, together with details of what actions have been taken and what has been achieved as regards to these four recommendations by the time of this Third Business Forum in 2009.

An **Agenda for the Entrepreneurship & SMEs Breakout Session** is also set out below in Annex 2. The Agenda includes the timings of the four main topics to be discussed.



Enabling Environment for Entrepreneurship and SMEs

Policy and Regulatory Reform needs Effective Implementation

The pivotal role of SMEs in the process of achieving economic diversification and sustainable development is already recognized in both the EU and in Africa. In order to fully support their development, the State is required to offer SMEs and entrepreneurs in general an enabling environment. There are many aspects to the enabling environment. Besides transparent, coherent laws for the protection and facilitation of business, other important elements of a business enabling environment are :

- A “clean”, predictable, transparent judicial system to administer and implement the laws.
- Equal access to justice.
- Protection of innovation whether by formal or informal enterprises.
- Review of tax regime to ensure that it is totally transparent and reasonably progressive.
- Provision of general infrastructure including power, water, roads, communication.
- Equitable access to education, healthcare and protection for workers ¹

Recognizing that SMEs are key contributors to business, governments everywhere are beginning to incorporate their role in their core development agendas. Some countries are also developing policies to enhance the status of SME in national economic development. However, there are also problems being observed at two levels of the policy agenda: the first is lack of coordination in terms of the wide array of policies that affect the SME potential (for example, as seen from the list above, these could range from infrastructure and finance to those that influence education and vocational training) and the second is frequent failure in terms of the implementation of policies. This emanates from the **failure to design effective policy implementation frameworks consisting of appropriate allocation of resource and design of programs and schemes as well as supportive regulatory reform** Policies have to be

¹ Kapila S., “Analytical Section of the Resource Guide to Upgrading MSEs in the Informal Economy”, a report to ILO, 2008.



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complemented by effective and operational policy implementation strategies to provide fruitful results.

In undertaking policy reform, international cooperation can play a role. **Most public policy decisions are only made after broad consensus is reached. Consensus building requires active facilitation and resources.** This has to be a nationally led but external input can present international experiences and assist in analyzing potential impacts of policy options and their implementation modalities.²

One aspect of the enabling environment, the removal of barriers to formal registration of business has gained much attention recently through the reports from the application of World Bank's Doing Business indicators. The Bank's 2007 entrepreneurship survey revealed that automation of business registration reduces the barriers to starting a business, as measured by the Doing Business indicators. In countries with electronic registration, starting a business takes less time, requires fewer procedures, and costs less. The survey also provided evidence that automating business registration can greatly increase the ease of starting a business. But registration, whether automated or not, does not remove the taxation implications of registration. Therefore besides greater transparency and efficiency in registration through automation, there is also need for long overdue attention to the incentive of graduated and reasonable taxation (including incomes and land taxes) encouraging greater number of business registrations. **Inappropriate fees and taxes can push businesses back into extra-legality.**

A fundamental limitation in the number of SMEs that can become legally registered is the requirement in any business registration for a permanent address. **Many SMEs are informal precisely because of the problem of securing property rights. Legal property rights systems in fact increase tax revenues to governments,** yet most African governments to date have not been actively promoting such reform from the perspective of SME inclusion in higher value markets.

Also once an SME registers, whether using a one-stop shop or any other efficient method, continuing demands for compliance to regulations regarding health and safety, local by laws, environmental regulations etc. still keep open doors for potential corruption.

² Mallon, R., "Approaches to Support the Development of an Enabling Environment for Small Enterprises", GTZ, 2002



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DISCUSSION POINT :

Which is the main regulatory reform that would improve the status of SMEs in global markets?



On access to financial and non-financial services

African SMEs have Problems in Delivering Consistent Quality and Adequate Quantity

The problem of quality and quantity gaps in terms of output is common to many small producers and suppliers and keeps them entrenched in their inferior position in markets. **These gaps are as much a result of inadequate access to working capital, services and technologies as of little awareness of business principles and dimensions of intra-enterprise capacity development.** Although there is a gender divide among African SMEs with mostly male entrepreneurs engaged in manufacturing and high-end service sectors and women concentrated in retail and personal services sub-sectors, both men's and women's small businesses are characterized by very limited capability in strategic business planning and lack of efficient business practices.

Improved access to SME focused financial and non-financial services are important for the upgrading of productivity and scale of business operations. Such services have until about a decade ago been more supply than demand driven, offered as part of SME development projects. Now that SMEs are recognized in the market, private sector service providers are emerging but are limited in their numbers and the appropriateness of what they offer. There is also the challenge of deepening the reach of the services to SMEs that are rural or that are not aware of their market potential and therefore actively demanding the services.

Business development services (BDS) refers to non-financial services that include

- training, technical and management advice;
- development and promotion of new technologies;
- assessment of markets and market information delivery;
- marketing support and provision of physical infrastructure;
- organizational and advocacy capacity development.



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In the face of unsatisfactory performance of public training systems, private delivery of training through private tertiary organizations and business linkages is a growing trend. Private training means:

- training offered by training businesses
- training by registered private trainers
- training by informal trainers on a commercial basis.
- training based on business e.g. training by a manufacturer to subcontractors or training by a franchiser to franchisees.

Efficient delivery of information and marketing support has often been done within a sub-sectoral approach or through intermediary organizations which have carved out a service delivery or service facilitation role for themselves. **SMES lack information on prices and markets (domestic and foreign); private sector business services; technology and regulatory requirements. ICT based information provision is on the rise in the region but still out of reach of millions of entrepreneurs.** Scaling up and context specific modalities still need to be formulated. There is also need for market based business development services that upgrade business skills, financial literacy and offer capacity development on how to link to other businesses and markets.

The role of financial services has also drawn attention in Africa from donors and social venture capital in the last few years. **Proactive financial intermediation is helping SMEs expand their reach but financial products to suit them are still at a formative stage.** As SMEs offer a mostly untapped market, large banks sometimes team up with microfinance institutions to design appropriate lending. There is also an emerging trend towards social venture capital and corporate philanthropy support to social entrepreneurship. Social enterprises extend the benefits of business to those hitherto marginalized in markets. Not-for-profit organizations such as trusts and NGOs often play a facilitative and brokering role.

For example, cash flow problems are common at the SME level as their access to lines of credit is limited. A new model in the region, but not new in Europe, is called factoring or invoice discounting. For example, here in Kenya, a commercially registered Factoring Facility (FF) is supported by core equity from a donor. The Facility is in the process of borrowing additional sums from social venture capitalists in order to “factor” the transaction between SME suppliers and large scale bulk buyers such as dairies, supermarkets and food processors. Most small scale suppliers cannot afford to wait the 30 to 60 days for payments from these



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companies as they need to more immediate cash to ensure that they meet their the ongoing flow of orders. The FF offers this cash, based on the suppliers' invoices to their customers, the large firms. The firms then pay the FF what they owe their suppliers plus a fee. This then replenishes the FF deposit fund from which it pays the suppliers. In order to maintain surplus funds at all times, the FF draws both from a donor grant and loans from commercial banks and social venture capital funds. Factoring mitigates the risk both ways so that big business feels more comfortable dealing with small suppliers and the cash strapped small suppliers are supported in the face of the 30 plus day payment period after delivery of goods. **Risk mitigation is essential in the demonstration of innovation at the interface between different levels of urban enterprises.** It also allows for the establishment of credibility of new business linkages.

The above is only one of the many ways that financial intermediation by the donor broadens out the scope of more effective market participation of the SMEs through intermediation at two levels: the firm that bulks the SMEs' products and the financial intermediary. Another example in the textbox below of financial intermediation from the agriculture sector also shows what is possible with SMEs.

Approached by a Business Services Facilitator working with avocado farmers, Equity Bank customized its loan procedures and product to suit the requirements of several thousand avocado farmers trying to upgrade their production through the use of expensive spray equipment and pesticide. The facilitator was able to negotiate with Equity Bank on behalf of the farmers to extend credit to farmer groups for agrochemical services. The credit was backed by the supply contract with a reputable exporter of avocados. The Bank then proceeded to develop an appropriate loan product to meet the needs of the farmers and waived the usual collateral requirements. The exporter paid the farmers through the Bank which deducted the scheduled payments before releasing net proceeds to farmers. Farmers also signed chattels mortgage which was also "stretched" to recognize avocado trees!

Kenya's Equity Bank is growing steadily into the leading bank catering to small scale rural enterprises and agriculture with mobile (on wheels) banking units accessing even relatively remote rural locations. This and other **banks are using group guarantee mechanisms or some form of character referencing as well chattel mortgaging but these are essentially non-secured loans.** None of them lend for start



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ups but rather the enterprises which are already set up and show some degree of sturdiness.

Donor guarantees as well as lines of credit to wholesalers targeting SMEs have opened up credit access for greater number of small businesses. However, there is still work to be done in deepening the credit reach and creating insurance, loan and leasing products specific to SMEs. For entrepreneurs that lack collateral, leasing equipment is a convenient solution. The creation of specialised non-bank leasing companies would assure efficient problem solution.

DISCUSSION POINT :

How can subsidy/guarantee be best used in increasing the demand and supply of services to SMEs?



Formation of Business Linkages

Business Linkages can be Facilitated by Policy, Incentives and Strong Business Institutions

Business linkages are found in the market at all levels. Producer or SME associations e.g. cooperatives and clusters are typical forms of **horizontal linkage organizations**. There are also forms of **vertical organizations** with the various value chain stakeholders are represented e.g. the apex organizations. It is the combined vertical and horizontal linkages that constitute the core of the value chain. Within the value chain, business linkages can be formed and facilitated between the larger and smaller businesses. Linkages can also be created through franchising agreements such as are increasingly being found in the region between multinationals and national level SMEs. **Franchising and supply chain linkages are already boosting the development for SMEs. If there was proactive policy facilitation through incentives and stronger support by intermediary institutions, there could be many more linkages between large business and SMEs.**

There is growing opportunity also for the formation of clusters of SMEs. Clusters can create economies of scale in delivery of services as well production. **For clusters to be established, firms have to be able to work together to create a competitive advantage.** The inability to do so in the past in Africa is related to the distrust that marks most business contexts where business relationships have a basis in social affinity in the absence of strong institutions to facilitate business. **There is no obvious reason why firms should not be able to create collective efficiency based on trust but its facilitation can be further encouraged if there is a clear niche in the market to which clusters can respond.** There can be subcontracting arrangements made with larger businesses or through public procurement. In some countries, public procurement and SME policies suggest a quota for SMEs but often this is not implemented or operationalized in a transparent manner.

Governments and donors such as the EU could jointly actively promote the creation of clusters using subsidies, infrastructure investments, tax incentives. Clusters of firms in specific industries could be supported to compete in regional and global markets. **SME clusters and national policy makers could work collaboratively together with international technical assistance to improve the business environment and**



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production standards and to create market linkages and increase investment.

DISCUSSION POINTS:

What can best support SMEs to become more proactive in forming business linkages horizontally and vertically?



The role of intermediary organizations

Intermediary Organizations can Play a Crucial Role in Services for SMEs

Business associations can be active in improving economic performance, but only when there is a clear service orientation in the associations and demand from the entrepreneurs. Associations can serve to facilitate the exchange of know-how and experiences among the members, to execute common activities that stimulate improvements in the companies and influence their business environment. The question really is whether in this region, these organizations are in fact playing this role and if not, why not. One institutional innovation that is being currently experimented with is sector specific apex organizations which focus on developing chain integration along sectoral lines and have as their members chain players' organizations. How successful they are has not yet been assessed since this has only been started a couple of years ago.

Intermediary organizations can play several roles :

- to enhance efficiency and effectiveness of service delivery (to expand the outreach) of the members;
- to enhance service providers' ability to sustain service delivery, business and market linkages;
- to develop social capital (stronger co-operatives, business associations etc.) by capacity development and facilitating linkages between private sector actors
- to build advocacy skills for the creation of an enabling environment for private sector development.

In Europe, intermediary organizations help to do advocacy for SMEs , assist with technologies for business registers, provide business information exchanges and facilitate business mentoring. All of these are areas in which African intermediary organizations can improve their services. The use of ICTs is still not widespread among SMEs and creating nodes for easy access and SME specific technical assistance is an area where cooperation could be designed.



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DISCUSSION POINTS

- (i) **Which 3 activities by intermediary organizations could best support SMEs in upgrading their productivity and business linkages?**



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Conclusion

The results of the discussions and debates on the four key topics set out above will be summarised and taken into account in preparing the Declaration that will be issued at the end of the Business Forum. So it is very important that we have very good in depth discussions and debates on all the issues included in these four key topics.

In addition, there will be a summary of the proceedings of the Business Forum and a new set of Recommendations or focus in key areas made and agreed by the delegates at this Business Forum, for actions to be taken and reviewed at the Fourth Business Forum to be held in two year' time, covering both the advancement of implementation of the earlier recommendations were necessary and the implementation of the new recommendations.



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Annex 1: Status of implementation of EU-Africa Business Forum recommendations.

3rd EU-Africa Business Forum: 28-29 September 2009, Nairobi, Kenya					
WORKING GROUP: Entrepreneurship & SMEs					
Overall Goals	Effective programmes supporting entrepreneurship are vital for the development of both Africa and the EU				
"ACCRA RECOMMENDATION S"	PUBLIC SECTOR RESPONSIBILITY	PRIVATE SECTOR RESPONSIBILITY	PROGRESS INDICATOR	TIMEFRAME/CONCLUSION	ACHIEVEMENTS BY 2009
Create a network of one-stop-shops that help company start-ups	<p>African states to fund the creation of this network.</p> <p>European Commission to ensure the creation of one stop shops can be supported financially through funding programmes.</p> <p>EU Commission to organise study visits for AU Commission staff to see existing one stop shop operations in EU</p>	<p>Support networks to manage / operate the network of one stop shops, ensuring introduction of start-up entrepreneurs to existing business networks</p>	<p><i>Budgets allocated to programme?</i></p> <p><i>No. of one stop shops created?</i></p> <p><i>No. of entrepreneurs assisted?</i></p> <p><i>No. of women entrepreneurs assisted?</i></p>	<p>National plans published within 1 year.</p> <p>Implemented over 3 years</p>	<p><i>Publication of a Best Practice and Guidance manual for COMESA Investment Promotion Agencies, based on study tours and workshops. Also, a restructuring of the OSS in Mali has been studied.</i></p> <p><i>Burkina Faso, Lesotho, Madagascar, Mauritius, Senegal, Angola, and Zambia have set up their one-stop shops. Results are already visible in terms of reduction from 56 (2006) to 23 (2008) days for starting a business as average in the 7 above mentioned countries.</i></p> <p><i>The example of Burkina Faso describes how the process has been made more efficient. Now, the formalities for starting and expanding a firm are carried out in one place, by one interlocutor, with one document and all that within a fixed timing of maximum 7 days. The EC's general budgetary support to Burkina Faso and its Enabling Enterprises Capacities Program helped capacity building of the Maison de l'entreprise and assisted enterprises with service vouchers in order to achieve the above.</i></p>



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<p>Devise national programmes promoting clusters</p>	<p>African states to develop and publish 5-year national programmes of support for clusters. Such programmes must have clear objectives in terms of the number of clusters, enterprises and sectors to be supported, tax (and other) incentives offered to companies locating in clusters, and also addressing questions on ownership of property within the clusters.</p> <p>European Commission to ensure the creation of clusters can be supported financially through funding programmes.</p> <p>EU Commission to organise study visits for AU Commission staff.</p> <p>AU Commission to develop cluster programme 'template' - to be adapted and customised as appropriate by states.</p> <p>AU Commission to research and produce annual cluster 'scorecard' on implementation of programmes.</p>	<p>MNCs to develop own 'cluster' policies with suppliers, and other SMEs in the value chain - mentoring, coaching, training, quality control. Support networks to manage clusters.</p> <p>Business support networks to draft MoU template for use between MNCs and SMEs in cluster.</p>	<p>No. of national programmes published?</p> <p>No. of clusters formed/funded?</p> <p>No. of clusters addressing specifically women entrepreneurs' needs created?</p> <p>No. of MNC-to-SME MoUs created?</p>	<p>AU Commission template by next Business Summit.</p> <p>National programmes published within 18 months.</p>	<p>A subcontracting Charter has been developed for Senegal under the aegis of the Subcontracting and Partnership Exchange of Senegal (BSTP-S).</p>
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<p>Entrepreneurship banking</p>	<p>EIB to insist on % allocation of funding to be devoted to start-up loans.</p> <p>EIB also to insist on greater transparency on origin of EIB funds.</p> <p>AU Commission to investigate the feasibility of creating an 'SME Bank'.</p>	<p>Private sector (African based banks) to develop simplified risk assessment criteria and methodologies for start-ups/SMEs.</p> <p>Banks to increase training of staff to better understand SME needs.</p>	<p>Publication of Bank – SME /entrepreneur code?</p> <p>No. of bank staff trained?</p> <p>% of EIB funds to start-ups?</p>	<p>Code: 1 year.</p> <p>SME training for bank staff: Annual figures</p>	<p><i>Credit lines have been developed for regional and national wholesalers for on-lending to SMEs in several countries the European Investment Bank (EIB). Over the period 2006-2008, the EIB has financed in Sub-Saharan Africa (Republic of South Africa included), 68 projects (a total of EUR 2201 million), of which 18 (or 26% in terms of operations) were intended to provide direct or indirect funding of start-ups. These operations, for an amount of EUR 469 million, represent approximately 21% of the total amount signed.</i></p>
<p>Entrepreneurship in education</p>	<p>African states to consult, develop and publish long term programmes (10 years?) supporting entrepreneurship in education. Such programmes should cover from primary school on; have 5 and 10 year targets; clearly involve the private sector and educational authorities in concept and roll-out; allow for a range of tools/methods (for both literate and illiterate); focus on IT skill development.</p> <p>AU Commission to instigate consultation process with states to prepare programmes, develop palette of targets; and subsequently publish scorecard on implementation of programmes.</p>	<p>The private - and educational - sectors to play significant roles in helping to develop and implement the national programmes.</p> <p>The MNC sector, in particular, to create/support technical training schools; develop vocational training programmes; and include entrepreneurship training in such vocational training.</p>	<p>Publication of national programmes?</p>	<p>AU Commission consultation to be complete within 1 year.</p> <p>Plans to be published within 3 years.</p> <p>Implemented over 10 years.</p>	<p><i>Private institutes for employable and entrepreneurial skills training delivery are on the increase given the shortage of post-secondary vocational training institutes. Market based business services providers are also being increasingly sought by entrepreneurs.</i></p> <p><i>The African Development Bank has a Women In Business Initiative which offers an integrated package of support to women-owned SMEs , which includes on-line business support and management tools.</i></p>



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<p>Red tape</p>	<p>African states to agree target of 1 week maximum for the procedures to create a company. AU Commission to 'map' the procedures currently in force in all states.</p>	<p>Private sector agreement on terms of code is necessary.</p>	<p>AU Summit agreement to set 1 week maximum period.</p>	<p>Agreement within 1 year. Achievement of 1 week deadline within 2 following years.</p>	<p>A study has been undertaken on Investment Relation & Servicing Systems (IRSS) in COMESA. Work has been done in Zambia to promote investor facilitation. Improvements have been registered by Doing Business 2009 (WB): 2 countries (Mauritius and Madagascar) out 46 have achieved the target, while one is very close to it (Senegal: 8 days).</p>
<p>Public procurement - payment</p>	<p>African states to agree code of conduct - inter alia - concerning payments by public sector (at all levels): setting payment terms; agreeing late payment penalties; ensuring contracts amended to include provision for penalty claim in case of late payment.</p>		<p>Publication of code of conduct</p>	<p>Within 1 year</p>	<p>Kenya's Public Procurement And Disposal Act, effective as of 1st January 2007, applies to all procurement of goods, works and services as well as disposal of assets by public entities. The Act makes specific provision for preferences and reservations targeting disadvantaged groups and micro, small and medium enterprises. The Act establishes the Public Procurement Oversight Authority. Its primary roles relate to ensuring procurement procedures established under the act are adhered to and complied with.</p>
<p>Two final, more general, points:</p> <ul style="list-style-type: none"> • there is a significant but unquantifiable need to build capacity in the private sector. Too much capacity building is concentrated on the public sector. Donor funding should be diverted for this purpose. • Secondly, the summit recommends the creation of economic and social partnership fora throughout Africa, initially at national level, then regional. 					



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Annex 2: Agenda for breakout sessions on Entrepreneurship & SMEs

28th September 2009 (Part 1)

Time	Speaker	Topic
14: 30 - 14: 40	Co-Chairs (EU and Africa)	Welcome and Introductions
14: 40 - 14: 45	Moderator	Explanation of discussion format Brainstorming : 4 key issues common to EU and African SMEs
14:45 - 15:30	Discussion	<u>Enabling Environment for SMEs</u> Which is the main regulatory reform that would improve the status of SMEs in global markets?
15:30 - 16.15	Discussion	<u>Access to Financial and Non-Financial Services</u> How can subsidy/guarantee be best used in increasing the demand and supply of services to SMEs?
16:15 - 17.00	Discussion	<u>Development of Business Linkages</u> What can best support SMEs to become more proactive in forming business linkages horizontally and vertically?
17.00 - 17.45	Discussion	<u>Role of Intermediary Organizations</u> Which 3 activities by intermediary organizations could best support SMEs in upgrading their productivity and business linkages?
17.45 - 18.00	Conclusions	Building Consensus on conclusions reached.

29th September 2009 (Part 2)

Time	Speaker	Topic
10:30 – 10:40	Moderator	WG Recommendations



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10:40 – 10:50	Co-Chair African Union	Comments
10:50 – 11:00	Co-Chair European Union	Comments
11:00 – 11:20	Participants	Discussion on Project Possibilities
11:20 – 11:30	Euro Chambers Co-Chair	Thanks and Way Forward

METHODOLOGY FOR DISCUSSION

1st Day

1. The start will be by welcome to the participants by the Co-Chairs and self- introductions (name and institution) by participants.
2. The moderator explains that we take 45 minutes per topic and encourages each participant to use examples from their country to illustrate their points.
3. A quick 5 minute brainstorm on 4 key issues that face SMEs in Europe and 4 in Africa.
4. Under each topic, general discussion is limited to answering the question and in the last 10 minutes of the 45 minutes per topic, a recommendation for action is reached.
5. In the final summing up of conclusions, any overlaps/similarities in conclusions/recommendations are pointed out and we try to bring these to 3 recommendations.

2nd Day

The second day is for adding to the recommendations already made and for any presentations that any of the group want to make. This can also be a time to

- re-cap on what African countries present as progress on entrepreneurship and SMEs in the last two years.
- describe in more detail possible projects for the coming two years before the next summit.
- agree what could be the key topics for the next bi-annual summit.