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THE LEAST DEVELOPED COUNTRIES REPORT 2018

OVERVIEW

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Entrepreneurship for Structural Transformation – Beyond Business as Usual

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This Overview can also be found on the Internet,
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FOREWORD

Nowhere else in the world is radical economic transformation more urgent than in the least developed countries, which have the challenge of accumulating productive capacities at an unprecedented speed, in the face of the rapid reorientation of global production and digital transformation, to achieve the Sustainable Development Goals by 2030.

At the centre of radical economic change is transformational entrepreneurship. *The Least Developed Countries Report 2018: Entrepreneurship for Structural Transformation — Beyond Business as Usual* demonstrates how transformational entrepreneurship generates many of the social and economic innovations that underpin sustainable development. Transformational entrepreneurs create new products and business models; they offer dignified employment; their success leads to broader improvements in the quality of life and even bolsters fiscal sustainability. Dynamic entrepreneurs also make a greater contribution to wealth accumulation and distribution.

In the least developed countries, however, underdevelopment and unfavourable forms of participation in global trade constrain the emergence of the dynamic, opportunity-seeking entrepreneurs needed for structural transformation. The dearth of dynamic local entrepreneurship endangers structural transformation and ultimately weakens national ownership and the potential impact of attaining the Sustainable Development Goals in the least developed countries.

The weakness of dynamic entrepreneurship has important implications in the least developed countries, where entrepreneurship policy is often mobilized as an alternative to unemployment and a remedy for structural inequalities. This type of policy is often an imperfect way of fostering high-impact and dynamic entrepreneurship, which requires a distinct and strategic approach and deliberate long-term nurturing that entail coordinated and coherent action and smart policies across a range of relevant policy areas.

The Least Developed Countries Report 2018 presents a compelling case for a structural transformation-centred approach to entrepreneurship policy in the least developed countries. The report underscores entrepreneurship policy based on a fundamental recognition of disparities in the contribution of different types of entrepreneurship to structural transformation and wealth creation. It establishes a more active and proactive stance for the State in steering the emergence of dynamic and transformational local entrepreneurship. Importantly, it calls upon the least developed countries not to overlook the pivotal and complementary role played by large enterprises, alongside medium-sized and smaller enterprises, with a view to the least developed countries formulating deliberate strategies to nurture entrepreneurship that has impact. By encouraging least developed country policymakers to avoid policies that might undervalue the benefits of entrepreneurship, this report makes an invaluable contribution to least developed country efforts to add value to their implementation of the 2030 Agenda for Sustainable Development.

Mukhisa Kituyi
Secretary-General of UNCTAD

OVERVIEW

Sustainable development, structural transformation and entrepreneurship

Sustainable development is enshrined as a global goal in the 2030 Agenda for Sustainable Development adopted by the international community in 2015 as an aspirational vision to shape the development strategies and policies of all countries, including the least developed countries (LDCs). Sustainable development implies a radical reconfiguration of patterns of production and consumption, and changes in the relationship between societies and the natural environment. It therefore requires the structural transformation of economies, especially in LDCs, which need to transition to high-productivity economic activities and sectors in order to tackle the traditional challenges of economic and social development in a new way that mainstreams environmental considerations.

The concept of sustainable development links three dimensions of sustainability — economic, social and environmental — and the 2030 Agenda emphasizes the unity of, and mutual support between, these dimensions. This three-dimensional view reflects the understanding that an exclusive focus on economic growth ignores and potentially hinders social development and environmental protection. It therefore calls for an integrated approach to development concerns, combining a growing and sustainable economy with environmental protection and the satisfaction of basic needs. Successive policy statements issued by Member States of the United Nations have emphasized the right and obligation of both developed and developing countries to pursue sustainable development strategies, while also acknowledging the policy space that this necessitates.

UNCTAD has long emphasized the importance of economic structural transformation to poverty eradication and long-term development in LDCs. Structural transformation refers to the transfer of production factors — particularly land, labour and capital — from activities and sectors with low productivity and value added to those with higher productivity and value added, which are typically different in location and organization, as well as technologically. This process allows an economy to continually generate new dynamic activities characterized by higher productivity and greater efficiency.

The 2030 Agenda is thus transformative, in so far as it requires a radical change in economic processes, in methods of production, consumption and transportation and in lifestyles. It also requires a transformation of the socioeconomic relationship within different societies, as well as with the natural ecosystem, to focus on the attainment of societal goals within environmentally sustainable boundaries.

In this context, LDCs need to undergo a process of structural transformation analogous to the historical transformations of developed countries and emerging market economies. However, they need to embark on this process while starting from a position of heightened structural vulnerabilities and in such a way as to avoid repeating the negative environmental consequences of the past. Such structural transformation has become a sine qua non for LDCs to fulfil the economic, social and environmental dimensions of sustainable development and achieve the Sustainable Development Goals.

Rural development in LDCs is an imperative, as agriculture continues to play a disproportionate role in LDC economies, absorbing two thirds of the labour force and generating some 22 per cent of economic output on average, compared with 8.5 per cent in other developing countries. This makes the transformation of rural economies central to the overall structural transformation of LDCs.

The expansion of productive capacities plays a pivotal role in sustainable development. According to UNCTAD, the notion of productive capacities encompasses the resources, entrepreneurial capabilities and production linkages that jointly determine a country's capacity to produce goods and services. Strengthening productive capacities is thus a key dimension of growth and structural transformation, which occurs through three interrelated processes, namely capital accumulation, technological progress and structural change. The development of productive capacities is thus inevitably influenced by the nature of the interaction between entrepreneurs, the State and markets.

Entrepreneurship is a diverse and multifaceted phenomenon that has been conceptualized in different ways. Behavioural definitions of entrepreneurship define an entrepreneur as a coordinator of production and an agent of change through innovation. Occupational definitions conceptualize entrepreneurship as the result of an individual's choice between wage employment and self-employment based on an evaluation of the returns offered by each. The latter conceptualization was formulated with the situation of developed countries in mind. However, self-employment in LDCs is less a matter of choice than a result of prevailing labour market conditions and a lack of alternatives. This underlies the distinction between entrepreneurship by necessity and by choice.

Most definitions of entrepreneurship share common elements, in particular innovation, opportunity seizing and opportunity creation, risk-taking, judgment in decision-making and the development of business organizations. Entrepreneurial activity occurs primarily in private firms or self-employment, but also in State-owned enterprises, cooperatives and non-governmental organizations. The most common organizational form in which entrepreneurial activity takes place is the firm, which encompasses a wide variety of types, including domestically owned and transnational companies, private firms and State-owned enterprises, and firms of different sizes and ages, operating in all sectors of economic activity.

Entrepreneurship, in particular through its innovative dimension, can make an important contribution to structural transformation in several ways. First, it is an important mechanism for shifting productive resources from economic activities with low value added and productivity to those with higher value added and productivity, whether in agriculture, industry or services. Second, it can stimulate investment and contribute to building a knowledge-driven economy, which plays a central role in economic growth. Third, even unviable innovations in production that introduce goods, services, production technologies or business models that are new to a particular setting may provide valuable information for future entrepreneurial decisions, including those of other entrepreneurs, in the form of cost discovery. All of these effects are particularly critical in LDCs that are in the initial stage of structural transformation. Entrepreneurship is thus a sine qua non of sustainable development.

Entrepreneurial activity also directly contributes to economic growth by stimulating job creation, improving skills and encouraging technological innovation, and can increase productivity by encouraging competition. Differences in the level of entrepreneurship or in types of entrepreneurship can thus have a significant effect on economic performance, and control for the traditional factors of production, namely land, labour and capital. Along with the benefit of increased incomes, economic growth is an important element of structural transformation. However, different types of entrepreneurs and firms vary in their contributions to structural transformation and economic growth. In particular, dynamic, opportunity-driven entrepreneurship may have significant positive effects in this regard, while survivalist entrepreneurs by necessity are typically less innovative, operate mostly in low productivity and low value added activities and produce traditional goods and services with established technologies. Their growth potential is therefore limited, and most related firms remain at a microenterprise stage. Such activities, although important to the survival of the entrepreneurs themselves, do not generate significant wider benefits. Survivalist entrepreneurs may become opportunity-driven entrepreneurs and have a more positive impact, yet such instances are rare.

The relative contributions to structural transformation and other developmental goals of different types of entrepreneurs and firms are an important consideration in policymaking. Resource allocation and vertical industrial policies directed towards particular sectors or economic activities should primarily target those firms with the greatest potential contribution to structural transformation. Equally, horizontal, economy-wide policies should be aimed at creating an environment conducive to the emergence of those types of entrepreneurship with the greatest potential to contribute to structural transformation.

The level and quality of entrepreneurship in a given country is influenced by both individual and social factors. A number of idiosyncratic factors influence an individual's propensity to engage in entrepreneurial activity, ranging from psychological, social and personality traits, to demographic characteristics such as age, gender and cognitive skills. The personality approach interprets entrepreneurial behaviours as reflecting behaviours such as a desire for success, a limited fear of failure, openness to experience, conscientiousness, extraversion, agreeableness, persistence in the face of failure and alertness to perceiving and acting on opportunities. Gender-based research has shown that the propensity of women to start a business may differ from that of men for cultural reasons or because of discrimination.

Entrepreneurship typically involves individuals yet occurs within an economic and social context that has a strong bearing on the types of entrepreneurs that arise and their chances of success. On the one hand, dynamic, innovative entrepreneurs can contribute to growth and structural transformation. On the other hand, the features of the broader environment, including the structure and dynamism of the local economy, can have a major impact on the kinds of enterprises than can be established and successfully operated. This relates in particular to the geographical location of entrepreneurial activity, specifically with regard to rural and urban areas in LDCs, as well as the level of development and structural characteristics of the national economy. Several structural features of LDC economies, including limited financial development, insufficient infrastructure, lack of institutional development, elevated risk levels and the disempowerment of women, tend to weaken entrepreneurship and enterprise development. Finally, limited urbanization and the disproportionate role of agriculture also have an important bearing on the nature of enterprises in LDCs.

Achieving a nuanced appraisal of the entrepreneurial landscape in the least developed countries

Entrepreneurship has increasingly become a focus of the development policy discourse and is presented, in the Programme of Action for the Least Developed Countries for the Decade 2011–2020 and the Addis Ababa Action Agenda of the Third International Conference on Financing for Development, as a key avenue to private sector development and employment generation, especially for women and youth. However, the analysis of entrepreneurship is fraught with complications and measurement problems, in particular in LDCs, impeding research on its role in economic development.

Widely used indicators of entrepreneurship include the extent of self-employment; the ownership, management or establishment of new businesses; and the number of new registrations of limited liability companies. However, aside from limited data coverage, these indicators are also strongly influenced by levels of development, limiting their usefulness as proxies for entrepreneurship. Moreover, the first two broad measures are negatively correlated with the third, narrower, measure. This results in high levels of entrepreneurship in LDCs according to the former, but low levels according to the latter.

Self-employment in LDCs is high, at 70 per cent of total employment compared with 50 per cent across other developing countries, and declining only slowly; around half the population is engaged either in early-stage entrepreneurial activity or in established businesses. However, since own-account workers and family workers comprise 97 per cent of self-employment, only a small fraction of the self-employed can be considered truly entrepreneurial.

Societal values towards business-related occupations in LDCs are remarkably favourable, yet there is an apparent disconnect between the considerable optimism of the general population and the more complex reality experienced by those who actually establish a business, and whose expectations of job creation are generally limited.

The most obvious distinction among enterprises in LDCs is between those in the formal and informal sectors. The prevalence of informal enterprises is difficult to measure; the scale of the shadow economy, at around 35 per cent of gross domestic product, provides a conservative indicator. The tenfold difference between broad indicators of entrepreneurship and the establishment of limited liability companies also highlights the predominance of informal enterprises.

A closely related, though by no means coextensive, distinction is between enterprises driven by opportunity and those driven by necessity. This is of particular importance because it is the former that primarily drive structural transformation. On average, there are 1.7 times as many early entrepreneurs in LDCs who describe themselves as opportunity-driven rather than necessity-driven, compared with 2.8 times as many in other developing countries; and the proportion of necessity-driven early entrepreneurs in LDCs ranges from 22 per cent in Ethiopia to 47 per cent in Malawi and Vanuatu, with the rest either opportunity-driven or having hybrid motivations. However, the subjective nature of self-reporting suggests that these figures are likely to understate the extent of necessity-driven entrepreneurship.

Innovation is limited among entrepreneurs in LDCs, and me-too businesses, based on imitations of existing activities, generally predominate. On average, only 15 per cent of early entrepreneurs in LDCs report the introduction of a new product or service, compared with 24 per cent in other developing countries, and entrepreneurial activity by employees is also more limited.

Entrepreneurial activity in LDCs occurs predominantly in sectors with low entry barriers and limited skill requirements, in particular consumer-oriented services such as those involving retail, motor vehicles, lodging, restaurants, personal services, health, education and social and recreational services. Involvement in more transformative activities, such as construction, manufacturing, transportation, communication, utilities, wholesaling and business-oriented services, is more limited. This suggests that the entrepreneurship potential in LDCs translates only to a limited extent into innovative businesses capable of playing a catalytic role in structural transformation.

Moreover, the entrepreneurial landscape in LDCs tends to be skewed towards early stages of entrepreneurship. In the majority of LDCs for which data are available, there are more than twice as many early entrepreneurs as established entrepreneurs, reflecting relatively higher rates of business discontinuation and lower survival rates. Some 14 per cent of adults in LDCs report having exited a business activity in the last year, compared with 6 per cent in other developing countries, and the principal reason for exit is low profitability.

Young adults aged 18 to 24 account for an average of 28 per cent of early entrepreneurs and 17 per cent of established entrepreneurs in LDCs, compared with 17 per cent and 7 per cent, respectively, in other developing countries, reflecting the youth bulge in LDC populations. Those aged 25 to 34 predominate among entrepreneurs across all country groups, yet LDCs are distinguished by a more rapid decline in the weight of older cohorts, in particular among early-stage entrepreneurs, giving rise to a lower average age.

LDCs also have particularly low levels of educational attainment among early entrepreneurs; only 12 per cent have a post-secondary education compared with 36 per cent in other developing countries. However, the relative youth of entrepreneurs in LDCs suggests that this proportion could increase rapidly as enrolment rates rise.

The gender distribution of early-stage entrepreneurial activity appears to be balanced in LDCs, with an average women-to-men ratio of 0.94, compared with 0.77 in other developing countries and 0.61 in developed countries and countries with economies in transition. However, this may reflect the disproportionate prevalence of survivalist forms of entrepreneurship among women in LDCs, as the women-to-men ratio among opportunity-driven entrepreneurs is similar across the three country groups. The gender distribution of registrations of limited liability companies is more unequal in LDCs than globally.

The informal sector in LDCs is dominated by microenterprises with fewer than five employees and small enterprises with between five and nine employees, which represent 74 per cent and 20 per cent of the total, respectively. The rest are medium-sized enterprises. Unpaid workers, generally family, make up 38 per cent of the employment in informal enterprises, and in most instances, the use of such labour declines sharply as size increases. Gender inequality is marked; 50 per cent of women employees are unpaid, compared with 33 per cent of men, while women have ownership over the largest part of their firms in only 30 per cent of the cases.

While most entrepreneurs by necessity are in the informal sector, some opportunity-driven entrepreneurs also choose to remain informal for strategic reasons based on the costs and benefits of formalization. The financial and non-financial costs of the registration process are a part of this calculation, yet other factors are also important, including a lack of information on the process and greater uncertainty about benefits rather than costs. Some enterprises may decide to remain in the informal sector to engage in cost discovery or ascertain the viability of a business model before incurring the fixed costs of registration. This may explain why formal enterprises that delay registration subsequently outperform those that registered during the start-up stage.

Rural enterprise is critical to structural transformation in LDCs, and differs significantly from urban enterprise. Most rural entrepreneurs combine agricultural production with non-farm enterprise, in a complex and multidimensional pattern of income diversification, directed both at mitigating risk and seasonality and at increasing income.

Non-farm rural income is increasing across sub-Saharan Africa, but tends to be concentrated in richer rural households and remains less important than agricultural income overall. As in urban areas, new rural enterprises tend to be concentrated in activities with low entry barriers, such as sales and trading, rather than in more transformative sectors. Consumption linkages with agriculture predominate in the initial stage of transformation, yet the supply of agricultural inputs and agroprocessing become more important as rural development progresses.

The rural enterprise situation in LDCs is strongly dominated by microenterprises, which account for 95 per cent of firms in some LDCs in Africa, and tends to be disproportionately located in areas closer to towns, where productivity is also generally higher. Proximity to urban markets is also an important determinant of enterprise success, as are enterprise size, land tenure and, to a lesser extent, the gender, educational level and prior income and/or wealth of entrepreneurs, as well as access to finance. There is a high turnover level and exit rate among rural enterprises, and seasonality is an important determinant of enterprise productivity and survival. Gender is not found to be a significant determinant of the likelihood of operating a non-farm enterprise, yet women-owned enterprises are on average less productive than men-owned enterprises, possibly reflecting broader constraints on women’s time use.

Social capital, networking and trust play crucial roles in rural entrepreneurship, as either barriers or enablers. Networks such as farmers’ associations, cooperatives and marketing bodies are often at the forefront of promoting rural development policies such as extension services, for example in agrobusiness, and access to rural credit.

An analysis conducted for *The Least Developed Countries Report 2018* assesses the effects of the characteristics of firms in the formal non-agricultural sector, excluding microenterprises, on their performance in employment and productivity growth. The dataset used confirms the dominance of small enterprises, yet the distribution of employment is more balanced; the median employment share is 20 per cent in small enterprises, 30 per cent in medium-sized enterprises and 47 per cent in large enterprises. Women account for 27 per cent of full-time employees, and the proportion declines slightly with enterprise size.

Overall, the analysis finds a significant positive relationship between firm size and labour productivity growth. Older firms experience significantly faster productivity growth, and both firm size and firm age have a significant negative effect on employment growth. This may reflect a tendency towards greater labour intensity among small firms and younger firms that have not yet attained a minimum scale of efficiency and therefore remain in a process of expansion.

An alternative specification confirms the effect of firm size on productivity growth, but suggests that it is largely driven by manufacturing firms, while the positive effect of firm age is only weakly significant. Small firms have a significantly higher rate of employment growth than medium-sized and large firms, and firm age again appears to significantly dampen employment growth. However, innovation is positively and significantly associated with productivity growth in manufacturing firms, and with employment growth in the full sample and both subsamples.

Access to finance consistently appears to boost employment creation by firms, while manager experience is associated with slightly lower employment growth, except for services firms. The presence of women in senior management is significantly associated with faster productivity growth, overall and in services alone; and exporting is associated with faster employment growth, overall and in manufacturing alone. The results also suggest faster productivity growth in enterprises that began as unregistered enterprises.

These results highlight the distinct roles played by firms with different characteristics in the structural transformation process. Smaller and younger firms are critical to employment creation, yet larger firms appear to be better placed to spur capital deepening and increased productivity. The sustainability of structural transformation thus hinges on a well-balanced ecosystem encompassing multiple types of firms, related in a dense network of production linkages. In this regard, enthusiasm about start-ups and microenterprises and small and medium-sized enterprises is understandable, yet it often appears to be overstated, in particular in the light of the low survival rates of such enterprises.

The local entrepreneurship dimension of major global trends

International trade is now widely seen as the primary source of developmental dynamism and industrial policy has largely been replaced by trade policy in developing countries. Whether and how the potential opportunities offered by global value chains (GVCs) can help to stimulate the entrepreneurship needed to drive structural transformation is a critical developmental question for LDCs.

GVCs are seen as having important advantages, allowing countries to specialize in particular functions or bundles of tasks rather than in specific industries. However, there has been surprisingly little research to validate the supposed advantages of GVCs in stimulating local entrepreneurship. The overwhelming emphasis of research is on employment gains, profit and learning opportunities for individual firms, as well as the benefits from foreign exchange earnings. Few conclusions can therefore be drawn about the potential benefits from GVCs for entrepreneurship, the sustainable expansion of industrial bases in LDCs or sustainable development, without considering the ownership of GVC beneficiary firms.

Assessing the effects of GVC participation on entrepreneurship for structural transformation requires an understanding of the nature and underpinnings of the process of economic upgrading that is widely associated with GVCs. The initial stages of upgrading, namely process and product upgrading, are typically the initial steps of structural transformation. However, the last two stages, namely functional and intersectoral upgrading, in most cases mark its accomplishment, and take place either through progression or leapfrogging. However, prospects for economic upgrading within GVCs are not straightforward. They are influenced by a complex and uncertain GVC environment and can be either hindered or facilitated by governance patterns and power relations within GVCs, which are overwhelmingly skewed in favour of lead firms. Entrepreneurs in LDCs are also severely constrained by the intense level of competition characteristic of the GVC segments most accessible to LDCs and by structural impediments in local business environments. Consequently, unlike those in more developed settings, entrepreneurs in LDCs may struggle to exploit GVC-related entrepreneurial opportunities or to adjust to changes in the GVC environment and therefore have to forego promising opportunities or be compelled to employ suboptimal competitive strategies.

The underdevelopment trap faced by LDCs is compounded by trade-related obstacles, which have contributed to the fact that the share of LDCs in global trade has remained below 1 per cent since 2008. Tariff escalation is an important barrier, both to the processing of agricultural products and to manufacturing, and tariff peaks continue to affect important sectors of GVC-related interest to LDCs, making preferential market access a critical factor in their integration into GVCs. This makes LDCs vulnerable to the tariff-hopping strategies of lead firms in GVCs, giving a high degree of footlooseness and uncertainty to GVC participation, in particular in light manufacturing sectors.

LDCs are predominantly a source of inputs for the exports of other countries in several sectors, largely reflecting their dependence on primary exports and increasing concentration in their export composition and export destinations. The participation of LDCs in GVCs is also marked by concentration in the production of traded goods that are particularly postponable, making them particularly vulnerable to global demand shocks.

The predominant mode of entry for LDCs into GVCs is through foreign direct investment, whereby the entrepreneurship element is chiefly foreign. This varies in importance between products, and is more concentrated in manufacturing than in agriculture-related GVCs, in which international trade remains important but GVCs tend to play a more limited role.

Agricultural sectors in LDCs are typically dominated by smallholdings and family farms, which are disproportionately affected by compliance costs linked to a variety of non-tariff measures, ranging from hygiene, health and traceability standards to ethical, labour and environmental criteria. However, LDCs are able to exploit niche markets in agriculture, especially through arm’s-length trade.

Despite the importance of agriculture in LDCs, and their apparent comparative advantage in the sector, the participation of LDCs in such GVCs is generally more limited than in other sectors. Considerable growth in contract farming has helped to integrate some smallholders into GVCs, helping to alleviate some compliance constraints, though often relegating smallholders to positions with weak bargaining power. However, contract farming also facilitates the exercise of market power over producers by GVC lead firms and their intermediaries. There is evidence of new forms of foreign direct investment in agriculture and increasing concentration that will limit the scope for looser forms of association with local producers, which are generally more conducive to local entrepreneurship.

Agriculture is also likely to remain a strategic sector in LDCs, and strengthening the position of farmers and rural businesses remains a legitimate objective of rural development programmes in LDCs, as in other developing and developed countries.

In manufacturing, LDCs are increasingly integrated into production networks linked to GVCs related to clothing production, mostly in East Asia, and have benefited in terms of employment, in particular of women, and rapid export growth. However, despite improving employment prospects for women previously excluded from formal job markets, the feminization of the sector has often entrenched poor working conditions and a structural lack of gender equality, with gender-based pay gaps being exploited as a source of cost advantages.

Value addition in the textiles sector remains elusive in most LDCs and prospects for economic upgrading remain severely limited, although they are marginally greater where GVC investors operate nearshoring strategies, targeting neighbouring countries to supply their own regional markets. The integration of LDCs into production networks is heavily dominated by foreign ownership and the record of fostering local entrepreneurship is poor. In a few LDCs, arm's-length or other non-equity forms of foreign direct investment engagement, such as subcontracting, have been facilitated by the prior existence of a potential domestic supply chain. However, the readiness of entrepreneurs in LDCs to become original equipment manufacturers or original design players in the textiles industry is incipient and currently confined mainly to relatively unsophisticated sectors.

Global price competition is strong in the textiles industry, posing a serious constraint to LDCs in sustaining their positions in GVCs and depressing wages. Weaknesses in infrastructure and trade facilitation also hinder the competitiveness of LDCs and tend to favour larger firms and those that are already part of supplier networks, as do volume and flexibility requirements. Entrepreneurs in LDCs, who generally operate small enterprises, thus face often insurmountable barriers to engagement with clothing-related GVCs.

Despite the advantage of greater complexity and the potential for enhanced skills development in electronics-related GVCs, the participation of some LDCs in this sector exhibits similar characteristics to their participation in clothing-related GVCs.

LDCs are constrained in their abilities to attract GVCs with different degrees of potential for economic upgrading. They mostly participate in low-value segments of GVCs, in which potential benefits are dissipated by acute competition pressures and the scope of entrepreneurship opportunities is limited. The participation of LDCs has direct and visible short-term effects with regard to foreign direct investment presence, employment and export growth, yet longer term impacts on capacity-building and the sustainability of the local industrial base are less apparent. Moreover, policy instruments widely used to support GVC participation may divert attention from the higher priorities of building productive capacities and facilitating local entrepreneurship, disadvantage local investors and lead to local market structures that impede the flourishing of transformative entrepreneurship.

Increasing value retention from GVCs is essential to the domestic resource mobilization required, yet the potential conflict between lead firm strategies and policies enabling entrepreneurship and upgrading may exacerbate structural deficits in LDCs. At best, the purported potential of the GVC model to deliver rapid industrialization and flourishing entrepreneurship remains unproven. GVC participation may compound the risk of LDCs graduating from the LDC category without the structural transformation required to sustain developmental progress.

The opportunities and challenges of GVC participation highlight the importance of obtaining a balanced mix of enterprises of different scales, rather than placing excessive emphasis on microenterprises and small enterprises in LDCs. Larger firms are generally better placed to absorb the cost disadvantages faced by LDCs and can often serve as incubators for entrepreneurial talent and the transfer of tacit knowledge.

The issues surrounding the participation of LDCs in GVCs reinforce the importance of high-impact entrepreneurs with the ability to overcome the obstacles to upgrading faced by LDCs. Examples of individual entrepreneurs overcoming such obstacles exist in LDCs as well as in other developing countries and policymakers can leverage the demonstration effects of such ventures to unleash transformational entrepreneurship and build synergies between policy innovation and public investment. Social objectives such as poverty reduction and increased food security often imply a focus on the most disadvantaged, yet promoting entrepreneurship also requires attention to be paid to those best able to establish viable and thriving businesses.

A country's revealed comparative advantage may be a useful indicator and policymaking tool with regard to engagement with GVCs, yet the overriding objective in LDCs is to ensure the evolution of the revealed comparative advantage and the development of dynamic comparative advantage in line with the goals of sustainable development. Since the weakness of local entrepreneurship in LDCs creates barriers to capturing gains from GVC engagement, this implies a need to disrupt the revealed comparative advantage, to launch the process of structural transformation. LDCs may be better served by an eclectic industrial strategy that simultaneously targets low-skill and high-skill sectors, and by non-equity modes of GVC integration, which tend to have a higher probability of positive spillovers compared with other modes of GVC engagement with more restrictive governance structures.

Contemporary trade and production favour high-level skills and disruptive entrepreneurship. The global competition for highly skilled human capital is demonstrated by the establishment in several developing and developed countries of programmes to attract talented and high-impact entrepreneurs and innovators. Adapting strategies focused on migrants and emigrants to compete with such programmes is a high priority in LDCs. LDCs stand to gain from providing increasing opportunities and incentives for temporary or permanent highly skilled migrants and high-impact entrepreneurs to return from more developed destination countries. There are opportunities to learn from the programmes and experiences of other developing countries and developed countries. Well-designed and targeted programmes that seek to match skills, potential technology transfer and dynamic entrepreneurship to development needs are more likely to yield desired results.

Finally, services exports from LDCs are overwhelmingly concentrated in tourism. Strengthening linkages with agriculture and creative or cultural sectors, in particular, can be an effective strategy to promote entrepreneurship and structural transformation. Reorienting tourism development in LDCs from a tendency to be overly focused on satisfying export markets, as well as exploring new and innovative approaches to promoting local value added and fostering local entrepreneurial engagement, could generate multiplier effects in terms of investment, upgrading and beneficiation in all three sectors.

Entrepreneurship in the least developed countries: Major constraints and current policy frameworks

An important starting point for policies to promote structural transformation through entrepreneurship is to understand the major internal and external barriers to enterprise growth.

There is growing recognition that the most significant internal barriers are psychological factors, such as the commitment of entrepreneurs to growth. Other widely cited factors include management capability, funding levels, a shortage of orders, sales and/or marketing capacity and the products and/or services offered.

External barriers at the national level include the business climate, which can give rise to direct, indirect and hidden production costs for firms, inhibit their adoption of new technologies, deter investment, weaken competitiveness and reduce market size. The labour market can also be an important obstacle, as the absence of social safety nets or alternative income sources drives many people unable to secure wage employment into often informal self-employment activities, marked by low productivity and low survival rates. Access to markets, including export markets, has a direct effect on the productivity, profitability, growth and survival of firms. There is empirical evidence, in LDCs and elsewhere, that, other things being equal, exporting firms have higher productivity levels than non-exporters in the same industry.

Entry regulations represent a key element of the incentive structure affecting the creation and formalization of new enterprises and the emergence of start-ups capable of competing with incumbent firms and challenging their business models. Disproportionately high entry costs have long been identified as a potential hindrance to the establishment of firms in many developing countries and this remains the situation in many LDCs despite some signs of improvement. In 2015–2017, start-up costs in the median LDC were 40 per cent of per capita income, compared with a world average of 26 per cent. Moreover, costs to start a business exceeded yearly per capita income in seven of the 46 LDCs for which data is available. In some LDCs, women are required to undertake additional procedures to start a business.

Access to finance is a major constraint to entrepreneurship in LDCs. Informal firms, in particular, have limited access to finance from formal lenders. Internal funds are by far the predominant source of financing for day-to-day operations, typically followed by supplier credits and loans from relatives and friends. Financial actors, whether formal, such as banks and microfinance institutions, or informal, such as moneylenders, consistently play a limited role, and microfinance institutions appear to be significant in only a handful of LDCs. Limited access to finance may be a binding constraint to productivity and enterprise survival, in particular in rural areas, where credit availability and access are crucial to the success of both farm and non-farm enterprises.

Without access to modern, affordable, reliable and efficient modern energy, enterprises in LDCs can neither compete in global markets nor survive and expand in national markets, due to impaired productivity. Three out of four of firms in LDCs are affected by recurring electrical outages. In sub-Saharan Africa, electricity supply interruptions equate to around three months of lost production time per year, resulting in the loss of around 6 per cent of turnover, and about half of formal businesses use generators, giving rise to additional costs. Improved access to energy and water is a necessary condition for the development of agribusiness value chains, which could unleash entrepreneurial opportunities in rural areas. Limited energy access also accentuates the lack of gender equality arising from gender-based constraints, by limiting the participation of women in structural transformation and entrepreneurial activities.

Increased access to, and effective utilization of, technologies based on information and communications technology (ICT) can support both entrepreneurship and structural transformation in LDCs. For example, mobile telephones can be used to increase agricultural productivity and address specific challenges faced by farmers, such as a lack of information and limited market access. Despite recent impressive strides in mobile telephone penetration, however, LDCs remain far behind other countries with regard to the provision of ICT infrastructure, such as for Internet access. Only 17.5 per cent of the population in LDCs accessed the Internet in 2017, compared with 41.3 per cent in developing countries and 81 per cent in developed countries.

The gender gap in Internet use is wider in LDCs than in developing and developed countries and widened in 2013–2017. The digital gap between LDCs and developing countries is significantly narrower among young people aged 15 to 24. Such patterns of Internet use have potentially important implications for the use of ICT to boost entrepreneurship among women and youth and electronic commerce (e-commerce). E-commerce can provide a growing entrepreneurial and development opportunity in LDCs, if more producers and consumers in LDCs can link to e-commerce platforms and if policies for building entrepreneurial and productive capacities prove effective. Common barriers to e-commerce development in LDCs include the insufficient development of telecommunications services, deficits in energy and transport infrastructure, an underdeveloped financial technology industry, a lack of e-commerce skills development, financial constraints on e-commerce ventures and technology start-ups and a lack of or weakness in an overall national e-commerce strategy.

In LDCs, there are gender-based constraints to women's participation in economic activities, which arise in large part from gender-based discrimination in laws, customs and practices. Such constraints inhibit women's access to inputs and resources, which can reduce both their disposition to engage in entrepreneurial activities and their chances of entrepreneurial success. Unleashing the potential of women-owned enterprises requires an examination of not only where gender-based constraints exist but also their interplay and combined effects. For instance, the requirement in some countries for a woman to have her husband's consent to start a business not only exacerbates administrative burdens but also substantially reduces the proportion of women-owned enterprises. Women's work and entrepreneurial engagement remains restricted by law in many LDCs; 32 LDCs have laws preventing women from working in specific jobs and six LDCs require additional procedures for women to start a business. Reforming such laws and regulations could improve the performance of women-owned firms.

Relatively few national development strategies in LDCs identify structural economic transformation explicitly as a pillar, yet many encompass policies aimed at achieving aspects of such transformation. All of the national development strategies in the 44 LDCs for which data is available contain multiple references to the need to support entrepreneurship, mostly under the economic pillar, but also under the social pillar, and many include clearly defined policies for this purpose. Areas of intervention relate mainly to improving the business climate and access to finance and facilitating training and business advisory services. In at least one third of LDCs, small and medium-sized enterprises are viewed as potential engines of economic growth and sources of employment and income, to reduce poverty, yet fewer envisage support measures for large enterprises. Specific policy actions to promote entrepreneurship or enhance entrepreneurial culture are generally limited and sometimes vague. Notable gaps in development strategies include the elaboration of policies with regard to the clustering of enterprises and discussions on the interface between policies related to industry, trade, investment, regional integration and entrepreneurship.

The interface between entrepreneurship and structural transformation is generally articulated more clearly in national industrial policies than in development strategies, yet around half of LDCs have yet to formulate such a policy. Little attention is devoted to the determinants of entrepreneurship, but a wide range of approaches are envisaged, to place enterprises at the core of industrial development. All of the industrial policy frameworks in the 20 LDCs that have such a framework include a mix of vertical, horizontal and functional industrial policies, although the distinctions between them are often insufficiently clear, the discourse on the synergies between them is relatively weak and the types of enterprises to be promoted are insufficiently articulated.

The goals of entrepreneurship and enterprise development policies vary widely and are both economic and social in orientation. In addition, the periods covered by national development strategies, enterprise development policies and national industrial policies are often inconsistent. About half of all LDCs also have yet to formulate an entrepreneurship development policy and the remainder have a development policy for microenterprises and small and medium-sized enterprises or a charter for small and medium-sized enterprises. Burkina Faso, the Gambia and the United Republic of Tanzania have formulated full national entrepreneurship strategies.

Most LDCs have a blanket approach to supporting entrepreneurship, and do not distinguish between different types of enterprises for policy purposes. The primary focus of policy interventions is to improve access to finance and provide a business-enabling environment by improving legal, regulatory, institutional and policy frameworks.

There is a need for entrepreneurship policies to extend beyond providing a business-enabling environment, to enable the greater prioritization of structural transformation in the strategic development plans and visions of LDCs and for a stronger alignment between development plans, industrial policies and entrepreneurship development policies towards achieving structural transformation. Entrepreneurship development policies in LDCs should include a monitoring and evaluation framework that assesses results against performance indicators and allows for lessons learned from successes and failures to be integrated into policies. Public support must also be steady throughout the different stages of the life cycle of an enterprise, recognizing that sustaining and scaling up businesses are as important as starting them. Policy priorities should also vary over the course of structural transformation, with some forms of support declining in importance as the private sector gains strength while other forms become more important as the needs of enterprises evolve.

Policies for transformational entrepreneurship

Harnessing entrepreneurship for structural transformation requires policies to support and sustain the dynamic and innovative enterprises that are central to structural transformation rather than to promote enterprise creation simply for its own sake. This requires effective enterprise development policies, institutions and reward structures to influence the trajectory of firms over time, support their sustainability and maximize their contribution to structural transformation and sustainable development.

The wider context of enterprise policies is critical. Entrepreneurship policies need to be an integral part of a wider set of strategies and policies for structural transformation and sustainable development, making coordination, coherence and a whole-of-government approach essential. Collaboration, consultation and dialogue between the public and private sectors is also important, and requires strengthening the capabilities of both the public and private sectors in line with development objectives. Internationally, developmental regionalism, official development assistance and South–South cooperation also have important roles.

Development plans, industrial policies and enterprise development policies in LDCs need to be more strongly aligned towards the goal of structural transformation. This requires clearly distinguished and effectively articulated entrepreneurship and enterprise development policies, tailored to national circumstances and stages of transformation; vertical, horizontal and functional industrial policies; and supportive policies in many different sectors, with effective coordination to ensure coherence. Enterprise development policies in LDCs should include a monitoring and evaluation framework, supported by an alignment between the time frames of different policies.

The experiences of countries with successful records of structural transformation demonstrate the potential impact of government-led initiatives and the benefits of broad-based, diverse entrepreneurship development programmes based on a holistic approach underpinned by public–private sector dialogue and collaboration. Lessons learned also include recognition of the importance of the following factors: achieving complementarity between programmes and between entrepreneurship development programmes and trade policies; combining continuity in the face of domestic political changes with flexibility in response to any flaws in programme design; and ensuring independence, transparency and accountability to avoid capture by vested interests.

There is also a need for a clear differentiation between types of enterprises, by size, nature and motivation, to tailor policy incentives according to their respective roles in structural transformation. Important policy objectives include absorbing survivalist entrepreneurs into more productive economic activities, through employment creation by more dynamic and transformative enterprises, and prioritizing support to more dynamic and innovative opportunity-driven enterprises. Formalization should be promoted and facilitated. The primary aim is not to eradicate the informal sector, but to maximize the contribution of enterprises currently in the informal sector to structural transformation. A gradualist approach, informed by the specific conditions in an economy, may be appropriate, focused on improving the understanding, ease and desirability of formalization and addressing the constraints faced by informal enterprises in achieving the necessary levels of productivity.

Entrepreneurship policies are often preoccupied with enterprise creation and with microenterprises and small enterprises, yet the expansion of large enterprises also requires support, given their critical role in increasing productivity, shifting production patterns, creating employment and fostering entrepreneurial skills and innovation capabilities among employees. Linkages between microenterprises, small and medium-sized enterprises and large enterprises should also be promoted, to foster national and regional value chains and open up opportunities for upgrading and growth in microenterprises and small and medium-sized enterprises.

Support to enterprises should be tailored to their specific needs and reflect the different stages of their typical life cycle, whether starting, sustaining and scaling up businesses or managing failure. Support should be sufficiently sustained to allow enterprises to grow and withstand market cycles and fluctuations, with clear performance-related criteria for the eventual removal of support, as well as for entitlement. The UNCTAD Entrepreneurship Policy Framework provides the basis for an effective entrepreneurship strategy to promote the creation of start-up businesses and promoting the expansion of dynamic enterprises requires policies to address the many obstacles faced by firms in LDCs.

The end of the life cycle of an enterprise can be as informative as the start to the rest of the economy. Successful entrepreneurship development strategies can maximize learning from enterprise failure by promoting informational spillovers and supporting a process of entrepreneurial discovery. Rather than denying the possibility of failure, entrepreneurship development programmes should therefore include an exit strategy for those enterprises that fail, to minimize the costs and maximize the benefits.

State-owned enterprises also have a role in boosting entrepreneurship for structural transformation in LDCs, including by increasing access to public services, notably energy and water supply, ICT services and transportation; providing public and merit goods; generating public funds; limiting private and/or foreign control of the economy; sustaining priority sectors; launching new industries; and controlling the decline of sunset industries. The role of State-owned enterprises is particularly important where the domestic private sector is weak and there is little interest from foreign investors, circumstances that are commonly found in LDCs. However, the conditions for their effectiveness are less typical in LDCs, highlighting the need for governance frameworks for State-owned enterprises underpinned by performance and learning feedback mechanisms, monitoring and evaluation frameworks and sunset clauses or exit plans.

Special measures for women and youth in development policies for microenterprises and small and medium-sized enterprises may be beneficial, but should be aimed primarily at addressing the particular obstacles faced by women and young entrepreneurs in accessing the inputs and resources required for successful entrepreneurship. Constraints to women's entrepreneurship may be a specific obstacle to rural transformation.

In this context, the extent to which a developmental State assumes its entrepreneurial functions is particularly pertinent in LDCs, where the private sector is weakened by a lack of institutional support and by information and coordination failures. The importance of innovation for the structural transformation process calls for a State that is entrepreneurial in its approach and marked by ambition, willingness and ability to lead the development process. This also encompasses making mission-oriented public investments that create and shape markets and providing long-term capital to sectors overlooked by private investors, in order to gradually crowd them in.

Public-sector capabilities are limited in many LDCs, yet they can gradually be acquired and one of the functions of a developmental State is specifically to spur such acquisition. Among such capabilities is the fostering of synergies and exploitation of complementarities with the private sector. A pragmatic, strategic, incremental and evolutionary approach is therefore needed, increasing public sector capabilities in parallel with progressively increasing engagement in spurring structural transformation through locally appropriate institutional reforms and by building on centres of excellence, promoting policy learning and nurturing coalitions for change.

In this context, the entrepreneurial role of the State includes improvements to regulatory regimes, including reviews and impact analysis, and extends further, to encompass efforts to address the constraints faced by entrepreneurs, through public investment in infrastructure, measures to improve access to finance, the nurturing of business clusters, the promotion of technological capabilities among firms, the enabling of firms to exploit opportunities for digitalization and the promotion of entrepreneurial skills development within education systems.

Public investment in infrastructure is particularly important in LDCs, especially in transport and trade facilitation, ICT and energy supply. The scale of investment required for transformational energy access requires exploiting the synergies between the public and private sectors.

National development banks can play an important role in financing structural transformation. They can support a developmental State by providing financing to public–private ventures and State-owned enterprises, financing infrastructure development and providing small and medium-sized enterprises in priority sectors with preferential credit or credit guarantees. However, effective regulatory and governance frameworks are important to their success, learning from past experiences.

The State can also play a useful role as a co-provider with the private sector of venture capital to entrepreneurs for research and development and innovative activities in designated sectors and by providing guarantees against risks in the early stages of innovative activity. Public support can also be targeted towards entrepreneurship, microenterprises and small and medium-sized enterprises and large enterprises through State-owned specialized agencies, funded by cost-sharing between the domestic and international private sectors and the State. In LDCs with substantial natural resource rents, well-managed sovereign wealth funds can help to attract additional long-term private investments in strategic sectors.

Special economic zones and industrial parks can offer a means of relieving the most binding constraints to firm productivity by holistically addressing multiple soft and hard infrastructure constraints within a defined area. If tailored to the binding constraints faced by producers and geared to the promotion of continuing innovation and the emergence of business clusters, such tools can generate positive spillover effects, in particular in countries with large infrastructural gaps. Such prospects hinge, however, on the gradual establishment of a dense network of linkages between businesses and between businesses and supportive institutions, in terms of both upstream and downstream activities and know-how and knowledge diffusion.

The technological capabilities that firms need to survive and thrive can be promoted through fiscal and other incentives for firm-level innovation, government procurement policies, training, public research centres to support innovation in particular sectors and public innovation awards. Accelerator programmes, business incubators, science parks and technology research hubs are widely used to kick-start high-growth entrepreneurship. Coherence and coordination between industrial policies and policies for science, technology and innovation are also critical, and policies for intellectual property rights should ensure that patent rights reward risk-bearing inventors and innovators while clearly defining conditions for patents to be transferred, to encourage further innovative activity.

Bridging the widening digital gap between developed and developing countries is essential for LDCs, to avoid further marginalization in the global economy. This requires significant additional public and private investment. Supporting digitalization, by helping enterprises to harness ICT and engage in the global digital and knowledge-based economy, also merits much greater policy support. The State has a leading role in this process, as a co-investor and through public procurement policies. E-readiness policies should be established to enable domestic firms to access and exploit e-commerce markets.

Finally, entrepreneurship education policies should be established that include soft skills, such as persistence, networking and self-confidence, and hard skills, such as business planning, financial literacy and managerial skills. Entrepreneurial skills development could also benefit from a shift in emphasis from education based solely on memorization and rote learning towards education based on experiential learning, problem solving, team building, risk taking, critical thinking and student involvement in community activities. Such changes increase the need for expanded education budgets.

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