International Growth Centre

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Drivers for diversification: Firm productivity and export growth

During the past decade of relatively high copper prices, Zambia enjoyed high GDP growth rates but employment growth has been inadequate and narrowly concentrated. Growth rates have declined sharply since 2014 due in large part to declining copper prices which reduced exports and foreign exchange earnings while putting pressure on exchange rates. Given these developments, there is renewed interest and efforts to define and drive a robust economic diversification agenda.

A discussion event, co-hosted by the IGC and the Zambia Development Agency, generated key insights on the importance of investment in quality management practices by firms in enhancing productivity of manufacturing necessary for continuous participation in the export market. Productivity and profitability of manufacturing firms is increased through the adoption of quality management practices, and this further increases the value and volume of exports – a key ingredient to Zambia's diversification agenda.

Competition spurs diversification and growth

Growth and diversification requires, among others, highly productive and competitive firms to meet local demand and exploit regional and international markets. Zambia is uniquely placed with 8 countries surrounding it, representing a high regional market within easy reach. However, Zambian firms need to produce competitively in order to be continuous exporters. The performance of manufacturing firms is dependent, among other things, on macroeconomic conditions such as exchange rate movements as well as microeconomic factors such as productivity-enhancing management practices and programmes at the level of individual firms. Recognizing these influences on firm productivity and export performance is important in defining appropriate policies to support the drive towards diversification and industrialisation.

The event brought together both local and international IGC researchers and key Zambian policy makers to discuss research findings and practices around firm capabilities and export performance relevant for policy dialogue in Zambia's drive towards diversification and industrialisation.

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The following two studies presented at the event explored the key aspects of quality management necessary for enhanced firm productivity as well as the characteristics of continuous exporters.

1. Management Quality, Productivity and Profitability of Zambian Manufacturing Firms

Grayson Koyi of the Institute for Economic and Social Research of the University of Zambia presented a paper on "Management Quality, Productivity and Profitability of Zambian Manufacturing Firms". Surveying manufacturing firms in Lusaka and the Copperbelt provinces, the study shows that quality management practices such as leadership; customer focus; benchmarking people and process management lead to significant improvements in productivity and profitability, suggesting that heightened adoption and implementation of quality management practices is a key factor that can spur the growth of the manufacturing industry in a country like Zambia.

It follows, therefore, that the pursuit of government's job creation and industrialisation agenda can be achieved, among others, through improvements in quality management at firm level. With this resonance in the Government's goal of creating productive employment in Zambia, there is thus a role that can and should coordinate agencies such as the Zambia Development Agency and the Department of National Productivity Development of the Ministry of Labour and Social Security in enhancing firm productivity.

The researchers call for strategic partnerships between industry, academia and government to foster knowledge exchange on quality management practices. Given the costs associated with investment in quality management practices – which are offset in the longer-term by improved productivity and profitability – the researchers argue for incentives that would encourage the adoption of such practices. These, however, need to be carefully crafted and should be linked to employment generation objectives justify possible revenue loss to government.

2. Exports, Intermediate Imports and Exchange Rate Volatility in Zambia

Neil Rankin presented a paper on "Exports, Intermediate Imports and Exchange Rate Volatility in Zambia". Using a firm export data from the Zambia revenue authority, the paper shows that Zambian trade values are highly concentrated and dominated by a small number of firms that participate continuously in the international market, with about 80% of export value being accounted for by a small group of continuous exporters.

Further, the paper shows that Zambian exporters do not participate in the export market for long, and that the survival rates for Zambian firms are the lowest of approximately 40 comparative countries.

Furthermore, contrary to popular views, the paper shows that a more volatile currency does not decrease export variety entry but rather increases it. The relationship between export variety churn and exchange rate volatility is higher amongst firms that import too. This suggests that sporadic trade participation may be a response by firms to exchange rate volatility as they seek out short-term arbitrage opportunities rather than long-term stable trading relationships. This research leads to key policy messages that are essential in economic and export diversification:

-Growth in number of continuously exporting firms can raise firm productivity

The first is the need to build a pool of firms that can become continuous exporters. New firms, either local or through foreign direct investment (FDI), are one source of this pool. The other is by encouraging sporadic exporters to become continuous, although this is unlikely to be easy given that these firms are, on average, different to continuous exporters. Here, the role of agencies such as the Zambia Development Agency becomes important in the identification and mentoring of such firms. It is important to note, however, that these new continuous exporters will need to have the types of characteristics that successful exporting firms in other countries exhibit – higher productivity, higher capital intensity, and access to imported intermediate inputs. Policies need to focus on the conditions, such as the business environment and productivity improvements, which facilitate this.

-Exchange rate volatility hurts competitiveness

The second area is exchange rate volatility. The results from the paper indicate that volatility encourages 'arbitrage' – firms taking advantage of this volatility to trade sporadically. The concerns with volatility of the kwacha amplifies the macro-industrial sectoral linkages of the economy, showing how a seemingly macro issue can have a profound impact on the micro productivity of firms, and ultimately their export performance. It therefore follows that growing non-traditional exports – an important objective for Zambia's diversification agenda – would require a stable macroeconomic environment augmented by productivity enhancing policies for firms. A more stable exchange rate could encourage these firms to become fuller participants in the export market.

Looking to the future

The outlook for the growth of Zambia's non-traditional exports [NTEs] remains positively **high**. However, until Zambian firms increase their productive capacities and efficiency, the regional market will be dominated by foreign internationally produced goods. Having the potential to grow is not enough, this potential must be must be realised into actual output and export growth. The role that coordinating agencies such as ZDA play in supporting export growth is important. However, there is a need to re-examine the investment incentive structure that are skewed positively towards foreign firms with huge capital outlays, ignoring the potential for local MSMEs. The role of Medium, Small and Microenterprises [MSMEs] is key in not only creating local employment, but also in diversifying Zambia's export portfolio. The capital benchmark of $500,000 required for firms to access investment incentives that reduces their costs of production is too high for MSMEs in a country where access to finance is the greatest constraint to firm start-up and growth. Given the right environment, MSMEs could become highly productive and continuous exporters – thereby increasing NTEs and drive the economic diversification agenda.