The Role of Financial Development on Private Entrepreneurship in Cameroon

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Abstract
The paper analyses the effect of financial development on private entrepreneurship in Cameroon measured by private capital formation. The data was obtained from the World Development Indicators data base and were analyzed using a two stage least square regression technique. The results showed that both elements of financial development (domestic credit and savings mobilization) positively and significantly influence private entrepreneurship in Cameroon. Also, household domestic demand for goods and services had a positive effect on private entrepreneurship. From a policy perspective, an important conclusion is that an effective way for private entrepreneurship to be promoted in Cameroon is by improving on access to finance and increasing incomes that will eventually produce mutually reinforcing effects that increase savings and demand.
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1.   Introduction

The role of entrepreneurs and entrepreneurship in the economic growth and development of any economy need not be over elaborated. Schumpeter (1911) recognized this role when he reiterated the innovative and creative activities orchestrated by entrepreneurs in an economy's development process. Their role can be seen from different perspectives such as; source of employment; a means of poverty reduction; actors in harnessing the judicious use of indigenous resources; source of new technologies; means of fostering competition. They also provide the main source of government revenue through taxes as well as enhance productivity in the economy. This role is further emphasized by Djankov et al. (2002) and Klapper et al. (2007). The authors argue that entrepreneurship is essential for the continued dynamism of the modern market economy and a greater entry rate of new businesses which can foster competition and economic growth. Indeed, entrepreneurs can be considered as the engine of sustainable economic growth and innovation within an economy.

According to Schumpeter (1911), the entrepreneurial process centers on the discovery, creation and profitable exploitation of markets for goods and services. Within this context and in line with Klapper et al. (2007), entrepreneurship is thus regarded as the activities of an individual or a group aimed at initiating economic activities in the formal sector under a legal form of business. Irrespective of their impending and important role in a country's development process, entrepreneurs and entrepreneurship process as a whole face a myriad of constraints both in developed and developing countries, with the case of Africa being most acute. Such constraints stem from low incomes and thus low savings, low levels of technology, political instability (especially in some parts of Africa), unfriendly government machinery, information asymmetry, poor institutions, high taxes, poor and inaccessible infrastructure and most importantly inadequate access to funds to start up businesses. Differences in intensity of these constraints are a fundamental explanation for the differences in productivity and thus development of countries in the world and the productivity gap existing between developing countries and advanced economies.

In Africa, the main handicap to entrepreneurship is seen to be inadequate access to funding. Indeed, several of the World Bank's Enterprise Surveys show that about 45% of firms in Sub-Saharan Africa identify access to finance to be a major impediment to their business as compared to 13% for countries in the Organization for Economic Cooperation and Development (OECD). This lack finance is attributed to their low savings which itself is a consequence of their low incomes, inadequate and inappropriate collaterals to obtain loans etc. This slows the creation and growth of new firms in African economies.

This has prompted stakeholders to lay more emphasis in developing their financial sector by enacting or moderating the policies, factors, and the institutions that lead to the efficient intermediation and effective financial markets in their countries. This is in a bit to facilitate the acquisition of financial resources to promote entrepreneurship. This is so because financial development allows some poor individuals to access credit and set up businesses (Bianchi, 2010) which facilitate or promote the creation of enterprises. Moreover, the financial sector promotes economic activities given that they ease the exchange of commodities through the provision of payment services and medium, mobilize and pool savings from a large number of investors, acquire and process information about enterprises and possible investment projects, and monitor investments (Tabi et al., 2011). Indeed, the veritable role of financial development in the entrepreneurial process and economic growth had been recognised earlier as Schumpeter (1911) posits that the services provided by financial intermediaries stimulate innovation and economic growth and further reiterated by McKinnon (1973), who argues that without access to credit provided

by the financial system, the constraint of self finance sharply biases investment strategy towards marginal variations within the traditional technology.

The case of inadequate access to finance has also received attention from the stakeholders of the financial sector and entrepreneurship development in Cameroon. Such measures range from the broadening of financial services provided by the formal financial sector, the liberalization of financial sector paving the way for numerous micro financial institutions, and the reinforcement of the Douala Stock Exchange Market etc. At the same time, several investment reforms have been undertaken in the country to promote local and international entrepreneurship and thus investment in the country. For instance, extensive incentive is provided for in the Investment Code of the country to encourage foreign and local investors to establish and develop their businesses. These incentives include freedom to transfer profits earned and to invest abroad; full exemption from taxes and levies for a period of 10 years; exemption from all custom duties and taxes on imports or exports; freedom to operate foreign currency accounts in the local banking system and a new Investment Charter with 4 regimes for tax benefits amongst others (*as laid down by Law N° 2013/004 of 18 April 2013 to lay down private investment incentives in the Republic of Cameroon*).

Moreover, the state of Cameroon has designed several entrepreneurship-oriented programmes to provide youths with small credits to start up business. In fact, the government of Cameroon and the International Fund for Agricultural Development (IFAD) is developing a FCFA 23 billion programme on youth entrepreneurship in the agro-pastoral sector. In addition, several business forums are organised while actions have been taken to create a one-stop shop and enforce the property rights. All these are done in an attempt to promote enterprise creation in the country. Despite all these efforts, access to finance and the level of entrepreneurship development in the country still remains a call for concern in Cameroon. For instance, World Bank rankings for 2012 as far as the Doing Business index is concern, ranked Cameroon 98th out of 183 regarding access to credit in 2012. At the same time, 68.02% of firms in Cameroon identify access to and cost of finance as a major constraint in their expansion (Benthum, 2012). Interest rates remain comparatively higher than the pre-reform era; domestic credit granted are quite still low despite the excess liquidity the financial system of the economy is said to be witnessing. Leasing institutions, housing institutions, hire-purchase companies are quite limited, and the activities of commercial banks in the country are more geared towards traditional banking function, with a focus on short-term lending, which accounted for about 87.3 percent of all credit to the economy in 1995 (IMF, 2007).

One would expect that given the proliferation and growth of financial institutions amidst the shortage of financial resources faced, existing and potential entrepreneurs in the country, there should be a tremendous outcrop of enterprises by private individuals to this effect. Unfortunately, the pace of enterprise creation and the number of enterprises newly created and private capital formation by private individuals in the country is still out rightly and comparatively low. For example, statistics from the Global Entrepreneurship Monitor (GEM) for 2014 show that Established Business Ownership Rate in Cameroon stands at 11.5%, nascent entrepreneurship rate was 26.35% but with an entrepreneurial intention rate of 55.57%. This motivates one to investigate the effect of financial reforms and development on private entrepreneurship. Furthermore, this paper is motivated by the fact that most studies as far as financial development is concerned centre on its macroeconomic and growth effects (Djoumessi, 2009, Tabi et al., 2011) rather than the channels through which financial development would affect the economy amongst which is through private enterprise creation and management. This study thus seeks to assess the effect of financial development on private entrepreneurship development in Cameroon. Specifically, the paper assesses the extent to which domestic credit provided by the financial sector and domestic savings influence private investment in Cameroon.

The rest of the paper is organised as follows: The second section situates the paper in its proper perspective by reviewing literature linking financial development and entrepreneurship. The third section identifies the data sources and discusses the method of analysis. The empirical results are presented and discussed in section four. The final section concludes the paper with some policy recommendations.

2. Literature Review

Bagehot (1873) holds that financial markets facilitate the accumulation of capital and manage risks of investment projects and industries while McKinnon (1973) and Shawn (1973) postulate that a well-developed financial system mobilizes savings and channels them to large scale investments. Levine (1997, 1999) identifies the channels through which financial development can influence economic growth via entrepreneurship. Firstly, it mobilizes savings from different savers for entrepreneurship. This enables investors to diversify investments leading to an increase in asset liquidity in the whole economy. Secondly, financial development facilitates risk management. This is done through pooling savings of individuals and diversifying them across a range of investments. Also, financial intermediaries tend to mitigate the risks associated with individual projects. Saint Paul (1992) further argues that a well-developed financial system encourages specialization in production through diversification of demand risks. In line with Greenwood and Jovanov (1990)'s role of financial intermediation in productivity growth, financial development reduces information costs by acquiring and comparing information about competing

investment projects. Financial intermediaries monitor borrowers and exert corporate control on behalf of many investors ensuring efficient management. The presence of these intermediaries ensures the effective separation of ownership from the management of businesses. Finally, financial development speeds the exchange of goods and services.

A good number of studies (Claessens and Fojen, 2006; World Bank, 2000; Rajan and Zingales, 1998) have explored the link between financial development and the real sector of the economy which includes household consumption, trade and government spending. Mobilizing household savings enables households to buy assets, start business, insure against income shocks, enjoy remittances (Claessens and Fojen, 2006). Meanwhile the World Bank (2000) and Rajan and Zingales (1998) hold that financial development increases investment through allocation of capital to the private sector. In fact, through better risks sharing, investors readily undertake high risks projects. Through financial development, financial intermediaries use products such as credit cards and debit cards to facilitate both domestic and international trade. Financial development equally has an important impact on public sector entrepreneurship. Claessens and Fejen (2006) hold that a well-developed government bond market can enable the government to raise cheap capital for investment projects and other developmental purposes.

A myriad of empirical studies have been carried out across the globe on the role of financial development on growth with very few laying emphasis on their impact on entrepreneurship or investment. However, the few that exist adopt different methodologies and variables and obtain interesting results. For instance, Holtz-Eakin et al. (1994) use data from tax records in the U.S. to examine the reduced form relationship between inheritance and entrepreneurship. The results show the veritable role wealth and finance play in entrepreneurship development. In their two studies of 1994 and 1995, Petersen and Rajan employed data collected by the Small Business Administration (SBA), and obtained findings which suggest that banking relationships play a veritable role for small firms.

Ngongang (2007) assessed the impact of financing sources and the regulatory costs effect on the propensity for entrepreneurship in Cameroon using data from the Center of Research in Economy and Poll (CRETES) and Cameroon National Institute of Statistics and Accounting (NIISA) based on 28 divisions in the then 10 provinces. By means of OLS multiple regression technique, the study finds that debt financing and traditional risk capital is insignificant for the entrepreneurship in Cameroon.

In another study, Llussá (2009) conducted a panel study on financial development, gender and entrepreneurship covering the period 2001 to 2004 in 41 developed and developing countries using data obtained from the Global Entrepreneurship Monitor and indicators of financial institutions from Beck, Demirgüç-Kunt and Levine (2000). By means of probit estimates the empirical findings of the study show that it is entrepreneurship by need that is most affected by financial development. Amit (2014) was more interested in assessing the impact of financial development, economic development and foreign investment on entrepreneurial development measured by production per Small and Medium Size Enterprise (SME) and fixed investment per SME for the period of 1992-93 to 2011-12. Employing the error correction model the result of the study shows that investment per SME is positively influenced by financial development in the long run. However, in the short run fixed investments in SMEs is influenced positively by foreign investment and economic development.

Messomo (2013) examines the contributions of microfinance institutions to the creation and expansion of micro enterprises in Cameron with the help of Schumpeter, Verstracte and Fayolle models of entrepreneurship. Using nine micro financial institutions in the country, he analyses the relationship between the services of micro financial institutions and the creation of small and medium size enterprises on the one hand and the relationship between the services of micro-financial institutions and the expansion of small and medium size enterprises on the other hand. The analysis shows that micro-financial institutions in Cameron finance more business expansion than business creation. Specifically, the micro financial institutions provide more lending, savings and money transfer services than microfinance and training services which are also important to small entrepreneurs. From a policy perspective, he recommends that small financial institutions should improve on their strategies and services so as to be able to provide a range of all services demanded by entrepreneurs.

Mandiefe (2015) observes that African countries are developing better economic and monetary reforms so as to gain the status of emergent countries over a certain period of time, and that Cameroon is not left behind given that she wants to be emergent by 2035. To this end, she verifies the short-run and long-run impact of financial sector development on economic growth and also verifies the gap of financial development that separates Cameroon and an emergent country like South Africa. Using the vector error correction model, he noticed in Cameroon a long-run relationship between economic growth and financial development while for South Africa there was a short-run relationship between bank deposits and economic growth. A long-run relationship between economic growth and financial development was also noticed. The South African economy moves towards its long-run equilibrium faster after economic shocks thanks to its good financial developed economy. The above analysis could be replicated as concerns the influence of financial sector development on the level of private entrepreneurship.

3. Methodological Issues

The study covers the period 1980 to 2013 and data are collected from the World Bank's World Development Indicators (WDI, 2015) with all units measured in terms of local currency. To avert the possible limitations of using broad money supply as a measure of financial development, such as the fact that it measures only the extent to which transactions are monetized, other measures of such as domestic credit to the private sector and savings mobilization levels are used as indicators of financial development while Gross fixed capital formation by the private sector is used as a proxy for private entrepreneurship. The justification of financial development as a determinant of private entrepreneurship is drawn from the model of McKinnon (1973) and Shaw (1973) in which they assert that a well developed financial system mobilises savings by channeling small-denomination savings into profitable large-scale investments. The simple linear transformation of the assumed relationship between financial development and private entrepreneurship can be captured by following linear equation in logarithmic transformation to permit interpretation in terms of percentage or elasticities:

$$LPENT_t = \alpha_0 + \alpha_1 LDCP_t + \alpha_2 LGDS_t + \alpha_3 INF_t + \alpha_4 LHCE_t + \mu_t \dots\dots\dots\dots\dots\dots\dots[1]$$

Where *LPENT* stands for private entrepreneurship, *LDCP* is domestic credit to private sector, GDS is gross domestic credit mobilized, I*NF* denotes price level or inflation and *LHCE* stands for household consumption expenses taken as a proxy for the demand for commodities in the market. The coefficients of the different variables are expected to be as follows; $\alpha_0 > 0;\ \alpha_1 > 0;\ \alpha_2 > 0;\ \alpha_3 > 0$ and $\alpha_4 > 0$

In the estimation process, OLS prediction shows inconsistency as the value of the regressors correlates with the error term, an indication of the possibility of either selection bias, omitted variable bias, model misspecification or a combination of all. To correct for these, the Instrumental variable (IV) technique with the application of the two stage least square (2sls) methodology is adopted for the study. The key variable is domestic credit which is instrumented by broad money (which measures the degree of monetization of the economy and has been used as proxy for financial development by other studies (Calderon and Lui, 2003; Odhiambo, 2004).

The fundamental ideas behind the IV technique warrants that there is prediction of new values for the endogenous variable using the exogenous variables in our structural model and adding one instrumental variable in this ca se broad money. The instrumental variable which is broad money (BM) helps to triangulate what the average values for the endogenous variable (domestic credit) would be, based upon similarities between observations in the sample, without the influence of unobserved characteristics. However, the IV technique assumes that the IV correlates with the endogenous variable and that the values of the IV and exogenous variable are unrelated to error values in the structural model. With these assumptions, the new predicted values for the endogenous variable will then be free of selection bias or unobserved characteristics, assuming the model is correctly specified. Thus, the IV technique allows us to cater for the problem of the endogeneity of the indicators of financial development particularly domestic credit and broad money supply.

Given the predicted values, we have adopted the 2sls technique. In the initial stage of the 2sls, each explanatory variable that is an endogenous covariate in equation (1) is regressed on all of the exogenous variables in the model, including both exogenous covariates in the equation and the excluded instruments so as to obtain the predicted values. Then in the second and last stage of the estimation process, the equation (1) is re-estimated normally, but this time with each endogenous covariate being replaced with the predicted values from the first stage.

4. Empirical Results

In order to carry out the estimation of time series variables, it was necessary to verify whether the time series was stationary or not. This was because the presence of unit root in the series could result to spurious results. To test for unit root of the variables the Philips-Perron test procedure was employed. The results are presented in Table 1.

Table 5: Philips Perron Unit Root Test Results

Variables	Levels		First Difference		Implied Order of integration
	Test Statistic	P-value	Test Statistic	P-value	
LPENT	-0.888	0.8562	-7.000	0.0000	I(1)
LDCP	-0.733	0.8381	-4.336	0.0004	I(1)
LGDS	-2.510	0.1130	-3.776	0.0032	I(1)
LBM	-0.641	0.8615	-4.336	0.0004	I(1)
INFL	-4.489	0.0002			I(0)

Source: Authors computation

The results showed that but for the inflation rate the variables are all found to be non-stationary at levels using a 5% level of significant. However, the variables turn to be stationary after the first difference at 1% level of significant. Hence the variables are denoted as I(1) variables.

The summary statistics and the pairwise correlation results are presented in Table A1 and A2 respectively

in the Appendix. From Table A2, it is observed that a positive correlation exist between private entrepreneurship and the household consumption, domestic savings, and financial development. This implies that an increase in these variables will be associated with an increase in private entrepreneurship. A negative relationship however exists between inflation and private entrepreneurship, which implies that an increase in inflation results to a decrease in private entrepreneurship.

The results of the two stage least square estimates of private entrepreneurship in Cameroon are presented on Table 2 below

Table 2: Results of the Effect of Financial Development on Private Entrepreneurship

Variables	Coefficient (standard errors)
D.LNDCP	0.3611* (0.2103)
D.LNGDS	0.4859** (0.2016)
INFL	-0.0011 (0.0062)
D.LNHCE	1.0676** (0.4411)
Constant	-27.04144*** (5.0422)
Wald chi2(4) = 268.51	
R-Square = 0.8814	
Number of observations = 34	

*=10%, **=5% ***= 1% level of statistical significance

Source: Estimated by Authors

The empirical estimates presented on Table 2 above show that except for inflation all regressors have a positive and significant effect on private entrepreneurship in Cameroon. Going by the elasticity coefficients, the empirical findings show that, improvements in the financial sector that propagate increments in domestic credit by 10% have the potency of initiating a 3.6% increment in the level of private entrepreneurship in Cameroon. Similarly, domestic savings mobilization which improves the financial sector has a positive and significant effect on the growth of private entrepreneurship in Cameroon. Specifically, an increase in domestic savings by 100%, will results to an increase in private entrepreneurship by approximately 49% whereas a 100% increase in household consumption expenses (demand for commodities) can trigger an increase in private entrepreneurship by 106%. Inflation has a negative but statistically insignificant influence on private entrepreneurship in Cameroon.

Facts from the World Bank shown by the Doing Business Index of Cameroon confirm the fact that access to credit constitutes a fundamental deterrent to private investment and entrepreneurship in the country. As such as long as means of raising highly productive and least cost credits are provided by financial institutions in Cameroon, there is an obvious potential for private enterprises to outcrop. At the same time, a great deal of investment capital to private individuals in Cameroon comes from their savings. This implies that as long as financial institutions provide a medium for savings, the rate of savings will rise, which will potentially increase investment levels as confirmed in the basics of the Harrod-Domar savings-investment-growth Models (Harrod, 1939, Domar, 1946). Thus, the implication worth drawing from this is that parameters of financial development such as domestic credit and domestic savings are positive financial instruments that can be used to promote private entrepreneurship in Cameroon. A result which is consistent with those of Amit (2014), who also found that financial development had a positive and statistical significant effect on SMEs.

5. Conclusion and Policy Implications

This aimed at analyzing the effect of financial development (measured by domestic credit offered by financial sector and domestic savings mobilization) on private entrepreneurship in Cameroon measured by private capital formation. The data was obtained from the World Development Indicators data base and were analyzed using a two stage least square regression technique. The results showed that both elements of financial development (domestic credit and savings mobilization) positively and significantly influence private entrepreneurship in Cameroon. In addition, household domestic demand for goods and services had a positive effect on private entrepreneurship. This implies that domestic credit, savings and household consumption are instruments that can be used to promote private entrepreneurship in Cameroon.

From a policy standpoint, our results suggest that an effective way for private entrepreneurship to be promoted in Cameroon is by improving on access to finance and increasing incomes that will eventually produce

mutually reinforcing effects that increase savings and demand and eventually propagate private enterprise creation to cater for the increase in demand.

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APPENDIX

Table A1. Descriptive Statistics

Variable	Observations	Mean	Std. Dev.	Min	Max
gfkf_gdp	34	14.22184	2.60621	9.494989	20.04565
gfkf_lcu	34	9.36e+11	6.53e+11	2.20e+11	2.50e+12
dcp_gdp	34	16.03081	8.543852	6.538039	31.24235
dcp_lcu	34	8.43e+11	4.44e+11	3.48e+11	2.15e+12
gds_gdp	34	19.14482	4.547251	11.25269	29.0996
gds_lcu	34	1.08e+12	4.23e+11	3.07e+11	1.77e+12
bm_lcu	34	1.15e+12	7.44e+11	3.20e+11	3.06e+12
infla	34	5.34427	7.02008	-3.206555	35.09446
hce_lcu	34	4.66e+12	1.46e+12	2.24e+12	8.01e+12

Source: The authors

Table A2. Pairwise Correlation

	LPENT	LDCP	LGDS	LHCE	INFLA
LPENT	1.0000				
LDCP	0.6299***	1.0000			
LGDS	0.8969***	0.5496**	1.0000		
LHCE	0.9558***	0.6003***	0.5822***	1.0000	
INFLA	-0.3586**	-0.2219	-0.3199*	-0.3847*	1.0000

* = 10%, ** = 5% and *** = 1% level of significance

Source: The authors