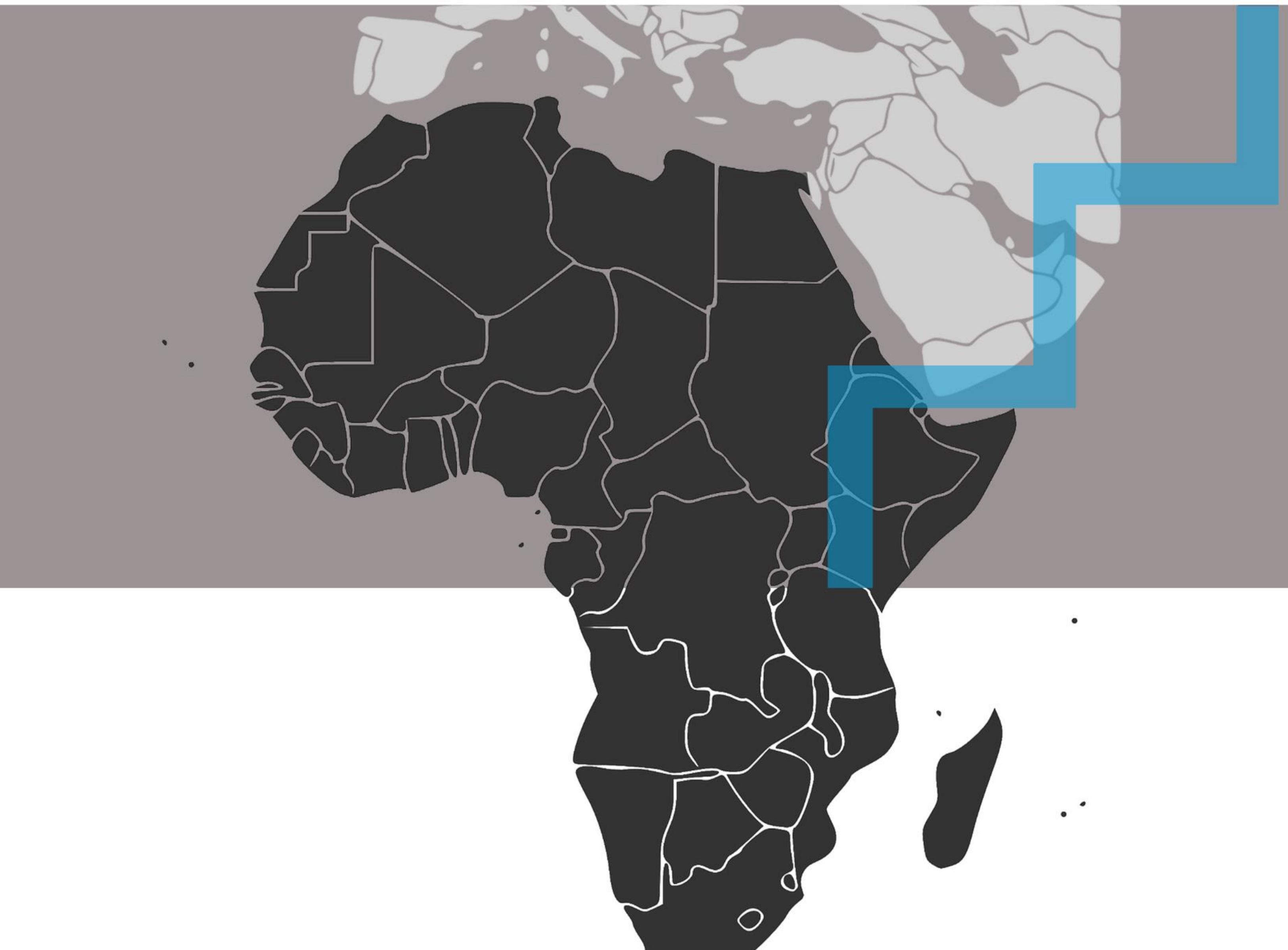
Best Practices: Formalization of Micro-, Small and Medium-sized Enterprises (MSMEs) in Africa



United Nations | Department of Economic and Social Affairs

GOOD PRACTICES

FORMALIZATION OF MICRO-, SMALL AND MEDIUM-SIZED ENTERPRISES (MSMEs) IN AFRICA

Source: Jamaica Observer.

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1. Introduction

According to the World Bank, global extreme poverty is expected to rise in 2020 for the first time in over two decades as the disruption of the COVID-19 pandemic compounds the forces of conflict and climate change, which were already slowing progress of poverty reduction.

It is estimated that the COVID-19 pandemic will drive an additional 88 million-115 million people into extreme poverty during 2020, and the number could rise to as many as 150 million people by 2021, depending on the severity of the economic contraction. Extreme poverty, defined as living on less than $1.90 a day, is likely to affect 9.1-9.4 per cent of the world's population in 2020, according to the biennial *Poverty and Shared Prosperity* Report.[i] Having a job does not necessarily lift people from poverty. Substandard working conditions are often related to poverty, inequality and discrimination. These are the conditions under which those in the informal sector perform.

1.1 What is informality?

> *"The pandemic and global recession may cause over 1.4% of the world's population to fall into extreme poverty. In order to reverse this serious setback to development progress and poverty reduction, countries will need to prepare for a different economy post-COVID, by allowing capital, labor, skills, and innovation to move into new businesses and sectors.*
>
> World Bank Group President David Malpass

The concept of the informal sector was first introduced by the International Labour Organization (ILO) in 1972. Since then, there has been much discussion on the definition, characteristics and causes of informality. In, the ILO Transition from the Informal to the Formal Economy Recommendation, 2015 (No. 204), the term "informal economy" is used to refer to all economic activities by workers and economic units that are, in law or in practice, not covered or insufficiently covered by formal arrangements. The term covers a range of workers and economic units, including individuals that are self-employed and small-scale service or manufacturing businesses. The sector encompasses covers the spectrum of unorganized economic activities in commerce, agriculture, construction, manufacturing, transportation and service. According to ILO, it now absorbs as much as 60 per cent of the labour force in the urban areas of developing countries. In contrast with employees in the formal sector who have regular hours of operation, a fixed work location and other structured benefits, most workers in the informal sector do not have access to secure work, benefits, welfare protection or representation. They are therefore condemned to a life of poverty and social exclusion.

There are different schools of thought regarding the causes of informality. One view is that the informal sector comprises potentially productive entrepreneurs who are kept out of formality by high regulatory costs, most notably entry regulations. Another school of thought categorizes individuals in the informal sector as those entrepreneurs who are productive enough to be able to participate in the formal sector but choose to remain informal in order to take in higher revenues through non-compliance with tax rules and other regulations. Members of the third school of thought argue that informality is a survival strategy for low-skilled individuals, who are too unproductive to ever become formalized. While informal sector activities are quite diverse, especially in terms of capital, income generation and technology, they may exhibit any of a number of characteristics such as utilization of skills acquired outside of the formal education system, unstable employer-employee relationships, lack of job security, and small-scale operations, among others. Notwithstanding, the sector does play an important role in providing jobs - although these are low-paid jobs with no security - and reducing unemployment and underemployment.

Table 1: Characteristics of the informal sector

Characteristics	*Employment*	*Enterprise*	*Habitat*	*Informal credit markets*
Description	1. Absence of official protection and recognition 2. Non-coverage by minimum wage legislation and social security system 3. Predominance of own-account and self-employment work 4. Absence of trade union organization 5. Low income and wages 6. Little job security 7. No fringe benefits from institutional sources	1. Unregulated and competitive markets 2. Small-scale operation with individual or family ownership 3. Ease of entry 4. Reliance on locally available resources 5. Family ownership of enterprises 6. Labour-intensive and adapted technology 7. Absence of access to institutional credit or other supports and protections	1. Unauthorized use of vacant public or private land 2. Illegal subdivision and/or rental of land 3. Unauthorized construction of structures and buildings 4. Reliance on low cost and locally available scrap construction materials 5. Absence of restrictive standards and regulations 6. Reliance on family labour and artisanal techniques for construction 7. Non-availability of mortgage or any other form of subsidized finance	1. Unregulated and non-subsidized 2. Easy accessibility 3. Availability in very small size and for short terms 4. Low administrative and procedural costs 5. Little or no collateral requirements 6. Flexible interest rates (from very high to no interest rate at all) 7. Highly flexible transactions and repayments tailored to individual needs

Source: Global Development Research Center, "The informal sector: distinguishing characteristics of the informal sector". Available at www.gdrc.org/informal/1-is_characteristics.html.

1.2 2030 Agenda for Sustainable Development and the informal sector

The adoption by the General Assembly of the Agenda for Sustainable Development (Assembly resolution 70/1 of 25 September 2015), which sets out the Sustainable Development Goals (SDGs), has given new impetus and urgency to efforts aimed at addressing the employment, human capital, efficiency and productivity deficits which impede inclusive economic growth. Micro-, small and medium-sized enterprises (MSMEs) serve as the backbone of the economy in developing countries through their stimulation of economic growth, creation of decent jobs, eradication of poverty and improvement of livelihoods. While it is estimated that formal MSMEs contribute up to 40 per cent of national income (gross domestic product (GDP)) in emerging economies, the International Finance Corporation (IFC) estimates that, globally, 74 per cent of MSMEs are informal. The informal economic sector is addressed, directly and indirectly, under many of the Sustainable Development Goals, particularly SDG 8: Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all.

The SDG targets are ambitious and require transformation of public and private activities. This transformation is associated with adapting new business models; introducing innovation, including new technology; and doing business differently – that is, more sustainably and more ethically. This process opens up new business opportunities for the private sector in general and for MSMEs in particular.[ii] According to the Business and Sustainable Development Commission, sustainable business models could open up economic opportunities worth $12 trillion and create 380 million jobs by 2030, with more than 50 per cent being located in developing countries.

Taking into account the fact that most members of the target population for meeting SDG 8 are poor or work in the informal sector, it is logical that the two themes - the theme under SDG 8 and the theme of the informal sector - are intrinsically linked. For example, target 8.3 calls for Governments to "promote development-oriented policies that support productive activities, decent job creation, entrepreneurship, creativity and innovation, and encourage formalization and growth of micro-, small- and medium-sized enterprises, including through access to financial services". While the indicator designated for this target is "Proportion of informal employment in non-agriculture employment, by sex", it is clear that broader informal economic activities, particularly in urban areas, also need to be examined and targeted.

Table 2: Linkages between the informal sector and the Sustainable Development Goals (SDGs)

Informal sector	consists of micro- and small enterprises that operate outside the formal/legal system of an economy. They do not use a licence to operate; pay no taxes for their activities; and do not have any protection for their labourers. The sector is predominantly set up by the lower-income households in cities and towns. The International Labour Organization (ILO) points out that "the expression 'informal economy' encompasses a huge diversity of situations and phenomena". ILO notes that "indeed, the informal economy manifests itself in a variety of forms across and within economies". The informal economy accounts for more than half of the global labour force and more than 90 per cent of micro- and small enterprises (MSEs) worldwide. Informality is an important characteristic of world labour markets, with millions of economic units operating and hundreds of millions of workers pursuing their livelihoods in conditions of informality.
SDGs	...*also* known as the Global Goals, were adopted by all United Nations Member States in 2015 in a universal call to action to end poverty, protect the planet and ensure that all people enjoy peace and prosperity by 2030. The SDGs are the blueprint for achieving a better and more sustainable future for all. They address the global challenges we face, including those related to poverty, inequality, climate change, environmental degradation, peace and justice.

Source: Hari Srinivas, « Sustainable Development Goal #8: decent work and economic growth – SDG 8 and the informal sector", research note E-117 (Kobe, Japan, Global Development Research Center, July 2020). Available at www.gdrc.org/informal/sdg8.html.

2. Informal MSMEs in Africa: issues and challenges

Understanding and addressing the constraints faced by MSMEs are essential for the continued development of communities and national economies, especially in light of the recent onset of the COVID-19 pandemic. The health crisis has triggered economic and labour-market shocks. While many economic sectors are being affected, the crisis disproportionally affects MSMEs — the backbone for many economies and a crucial source of income and employment for many informal workers and their communities. An International Trade Centre (ITC) COVID-19 business impact survey (International Trade Centre, 2020) gathered evidence of the impact of COVID-19 on Africa, and two out of three businesses said they had been strongly affected by COVID-19, mostly with respect to reduced sales (75 per cent) and/or difficulty accessing inputs (54 per cent). The survey also found that informal enterprises were 25 per cent more likely to state that the pandemic was pushing them towards bankruptcy.

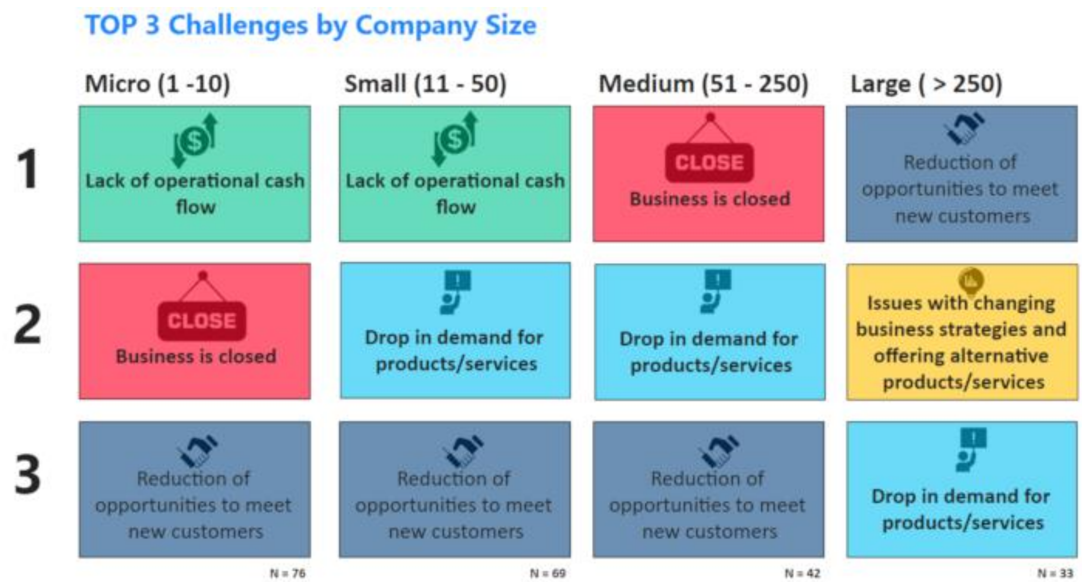

Figure I: Impact on businesses of the COVID-19 pandemic in Africa: top three challenges faced [ranked from 1 (highest) to 3 (lowest)], by company size.
Source: United Nations, Economic Commission for Africa, “Insights on African businesses’ reactions and outlook to COVID-19”. Available at archive.uneca.org/publications/insights-african-businesses%E2%80%99-reactions-and-outlook-covid-19.

Micro-, small and medium-sized enterprises (MSMEs) play a crucial role in the economic development of African countries. They constitute more than 90 per cent of businesses and employ about 60 per cent of workers, many of whom are women and youth, who tend to be poorer and more vulnerable. According to the 2015 *ILO World Employment and Social Outlook* report , sub-Saharan Africa has the highest labour participation worldwide, while youth unemployment was 11.8 per cent in 2014. Although such a demographic seems to be an advantage for Africa, vulnerability in employment is a real challenge, with 8 out of 10 persons affected, and working poverty is widespread.[iii] Future growth depends on greater MSME productivity.

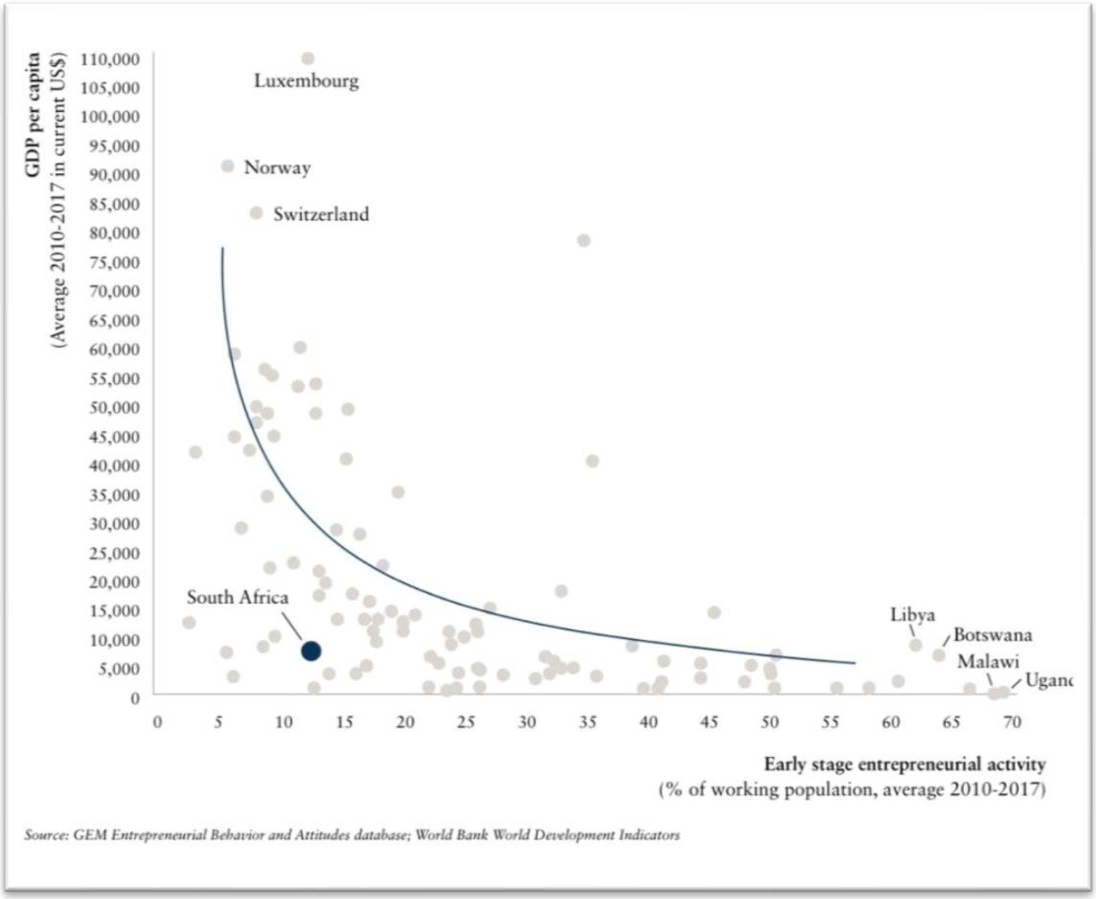

Figure II: Early-stage entrepreneurship and gross domestic product (GDP) per capita

According to the International Trade Centre (ITC), MSMEs are "the missing link" for inclusive growth. They are a vital engine for the African economy, as they drive growth, create employment - especially among youth - and spearhead innovation. They remain an important customer base for the larger companies across the supply chain while at the same time supplying vital goods and services to companies and households. As such, they contribute significantly to keeping the wheels of the economy in motion.

MSMEs play a major role in furthering innovation through their design and incubation of new technologies and business models and their generation of new ideas. Many of Africa's MSMEs have the potential to become successful companies in the future, which can put the continent on a sustainable path to growth and prosperity. Yet, informality remains a major hurdle. For example, in South Africa only 14 per cent of businesses in the MSME sector are formalized,[iv] thus limiting their growth and productivity.

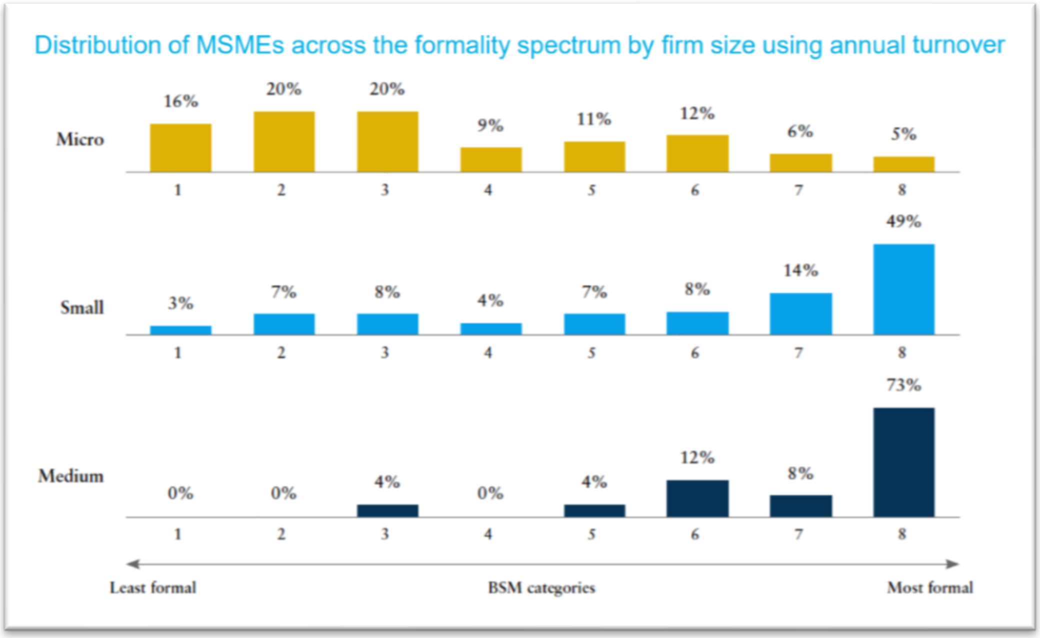

Figure III: South Africa: distribution of MSMEs across the formality spectrum, by firm size (using annual turnover) *Source*: FinMark, FinScope 2010 South Africa Small Business Survey (IFC PowerPoint Presentation 2019).[v]

African MSMEs are generally less productive than larger enterprises and often struggle to survive and grow. As a result of their limited productivity, they usually pay lower wages, operate in low value added and labour-intensive sectors, and use little technology. Their rate of failure ranges from 50 to 90 per cent.[vi] Informality is a major contributing factor to the lack of productivity and the high rates of failure, which gives rise to a number of challenges such as low levels of investment and lack of access to finance.

MSMEs in Africa face a large financing gap, estimated at more than $136 billion annually.[vii] Many report lack of access to credit - due to high interest rates, large collateral requirements and a burdensome application process - as the biggest constraint on their growth. It is especially difficult for women to obtain financing, as fewer African women have bank accounts, compared with men, and legal rights related to family capital and collateral can be restrictive, given local landownership laws and customs. Investors cannot invest in unregistered informal enterprises, which for their part cannot raise funds through formal channels.

Box I: Nigeria: MSME competitiveness and women–owned enterprises

ITC carried out an SME competitiveness survey in Nigeria in 2018, with specific focuses on women entrepreneurs and SME financing. As part of the SheTrades Initiative, which aims towards extending the international reach of women-owned enterprises, the survey interviewed 394 firms that are active in agriculture, mining, manufacturing and services. The data show that 45 per cent of women-owned companies that were surveyed, especially microenterprises and those operating in the manufacturing sector, had no business bank account. The younger the firm (also related to the age of its entrepreneur), the less likely it was to have a bank account. Two thirds of respondents cited difficulty in accessing credit as a barrier to business expansion. Financing was a particular problem for enterprises that were not part of a value chain, highlighting the benefits that international trade can bring to SMEs, particularly if they can leverage their larger buyers' credit to finance themselves.

Source: ITC SME Competitiveness Survey in Nigeria 2018.

MSMEs in Africa also face other major challenges which include lack of managerial capacities and technical skills, limited access to markets, high cost of production, weak infrastructure including information technology (IT), a lack of incentives, an uncoordinated policy environment, heavy taxation and a multiplicity of tax obligations, an unfriendly and burdensome regulatory framework, and - in general- a difficult environment for doing business. Despite reforms, most African countries are still ranked in the bottom half by the World Bank Ease of Doing Business reports.

From a trade perspective, intra-African trade is not likely to improve if factors that inhibit the participation of MSMEs are not addressed. This is likely to serve as an impediment to the successful implementation of the African Continental Free Trade Area (AfCFTA).

3. Best practices

Formalization of enterprises - which is part of a multidimensional and balanced approach, as outlined in the ILO Recommendation concerning the Transition from the Informal to the Formal Economy, 2015 (No. 204) - is also essential for the formalization of employment in those enterprises.[viii] The formalization of MSMEs goes hand in hand with a conducive business environment, economic growth and better working conditions. It also leads to increases in tax revenues which are needed to provide public goods and services. Formal businesses benefit from enterprise formalization to the extent that it reduces unfair competition from informal enterprises. Formalizing enterprises gain access to finance, business development services and technologies and reduce their exposure to government fines. They can also participate in public biddings or act as suppliers or retailers for larger companies. Some of the good practices emerging from support of MSME formalization are presented below.

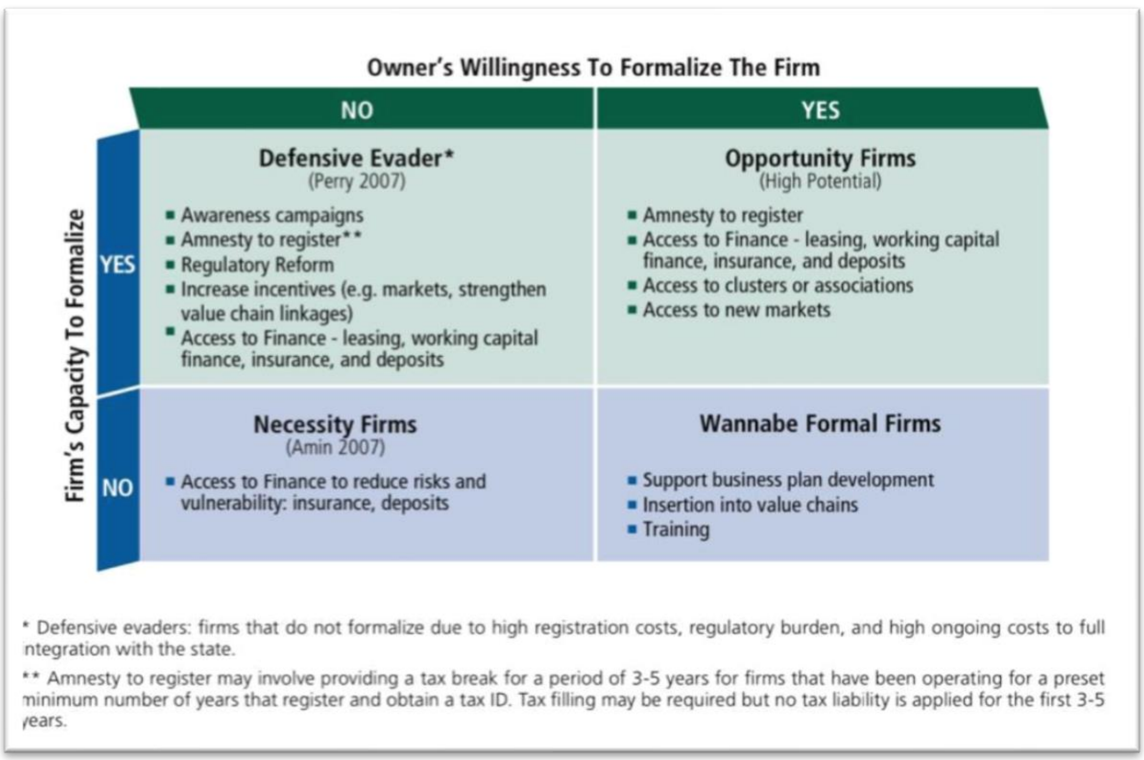

Figure IV: Framework for differentiating informal sector firms based on willingness/unwillingness and capacity/incapacity to formalize
Source: Stein, Ardic and Hommes (2013), figure 8.

3.1 Institutional frameworks

In 2016, ILO conducted a study of MSME promotional agencies, which identified good practices and lessons learned with respect to the configuration and operation of such agencies. The study addressed both the regulatory and institutional frameworks, and the specific operational factors that underpin the defining criteria for success of government-led SME promotion agencies.

Box II. Good practices for MSME promotional agencies

1. The setting up of an SME promotion agency, through which all government support to the sector is channelled, proves more efficient than spreading resources over various support organizations.
2. Some agencies use an indirect approach to administration of programmes: they implement programmes while contracting third parties to provide the services.
3. The inclusion of stakeholders and other public and private sector parties has improved the legitimacy and relevance of the agency.
4. A stable funding mechanism is key to ensuring the long-term effectiveness of the agency.
5. It is important for agencies to become learning institutions and adapt interventions to new needs.
6. High-level professionals with long-term experience improve the quality of products and services provided.
7. A large variety of support programmes has translated into the inefficient and ineffective use of available resources.
8. The law may act as an impediment to SMEs by charging a fee for business consulting services.

Source: ILO, *SME Promotion Agencies: Is There a Best Set-up? A Quest for Good Practices* (2016).

The Ghana Enterprises Agency (GEA) was established in November 2020[ix] to replace The National Board for Small-Scale Industries (NBSSI) which was the government agency under the Ministry of Trade and Industry mandated to promote and develop MSMEs. The main objective of the GEA is to oversee MSMEs and to coordinate their interrelationships and stimulate their development by:

- Contributing to the creation of an enabling environment for small-scale enterprise development
- Contributing to the development of an enterprise culture in Ghana by facilitating access to credit
- Facilitating MSME access to substantial and high-quality business development services to enable growth.

The services delivered include funding, business development and business performance. Among its achievements to date, the NBSSI:

- Trained approximately 65,000 youth through innovation hubs and apprenticeship programmes, with 62 per cent of those trained being women
- Disbursed about 70 million Ghanaian cedis (GH₵) and facilitated access to international markets
- Provided business acceleration services for productivity and quality improvement to 254 MSMEs through the KAIZEN methodology
- Supported, via the NBSSI Business Advisory Centres, 350, 000 entrepreneurs (73 per cent of whom are female) through the disbursement of approximately GH₵ 45 million in loans
- Established over 13,000 new businesses 70 per cent of which are led by women[x]

The NBSSI now plans to formalize the activities of MSMEs through digital means, and intends to fund the efforts of approximately 500 enterprises to scale up and move their start-ups to digital platforms.[xi]

Figure V: National Board for Small-Scale Industries (NBSSI) registers MSMEs
Source: Accra Metropolis/Instagram.

Following the onset of the COVID-19 pandemic, the NBSSI set up a registration point in the Accra Metropolitan Assembly City Hall for the businesses in the Accra Metropolis that were affected. Registration of those businesses was one of the activities carried out under the Coronavirus Alleviation Programme Business Support Scheme (CAPBuSS) which was launched to support MSMEs harmed by the pandemic. According to the Accra Business Advisory Centre, completion of the registration process takes about 30 minutes, if businesses have their taxpayer identification number (TIN) and business certificate. The scheme has served as an incentive for promoting formalization of informal SMEs.

Figure VI: MSME market in South Africa
Source: FinMark, *FinScope South Africa Small Business Survey 2010* (IFC PowerPoint Presentation 2019).[xii]

In South Africa, the total size of the MSME market, including formal and informal enterprises, is 5.78 million. Many micro- and very small enterprises are creating opportunities for self-employment, while only a few medium- to largesized enterprises have the capacity to employ more people.[xiii] In order to improve on the services provided to MSMEs, the Government of South Africa integrated all of its existing support agencies into a Small Enterprise Development Agency (Seda). This integration is expected to improve the efficiency and the effectiveness of government support. The aim of this government initiative is to establish Seda as the centre of excellence for small enterprise development in South Africa. Seda was established through integration of a significant proportion of the government-funded small enterprise support agencies across all levels of government. These agencies include public, semi-public and private organizations at the local, provincial and national levels, which were all established to support MSMEs. These changes should be the basis for a more efficient and effective system of small business support. As Seda is directly funded by government, it has a large geographical coverage and presence in provinces and municipalities across South Africa.[xiv]

Good practices	**Mode of service delivery** - An indirect and network approach with strong collaboration with relevant stakeholders
	Services offered - Services, tools and programs adapted to changing needs of SMEs - Activities developed in close cooperation with public and private stakeholders
	Human resources - High-level professionals with long-term internal work experience - Collaboration with other stakeholders limits increase in the need for human resources
	Impact assessment - Evaluations to assess the impact of products and services on a continuous basis to monitor achievements - Independent external evaluations carried out by third parties
	Enterprise support system - The set up of one SME agency, through which all government support is channelled, is more efficient and effective
Lessons learnt	**Defining SMEs** - Application of different SMEs definitions in support programs
	Services offered - Too many scattered support programs can reduce efficiency and effectiveness
	Lack of additionality - No added-value to existing services and mechanisms proves limited support
	Financial resources - Funding mechanisms dependent on short-term political choices result in budget instability - Constrained resources that are not proportional to the size of the country
	Enterprise support system - Lack of clear coordination amongst support measures organizations can lead to duplication of efforts and inefficient use of resources

Figure VII: SME promotion agencies: overview of good practices and lessons learned
Source: ILO, *SME Promotion Agencies: Is There a Best Set-up? A Quest for Good Practices*, 2016.

3.2 Regulatory environment

While MSMEs remain the backbone of Africa's economy, the slow rate of growth of entrepreneurship and the slow rate of creation of new enterprises continue to be a major concern. The burdensome regulatory environment - which inhibits business start-up and growth - is a major contributing factor. According to the World Bank Enterprise Surveys, the main reasons given by MSMEs for not registering their businesses are the lack of information on how to register an enterprise, the time required to complete the registration process, the taxes that registered businesses would be required to pay, and the perceived lack of benefits accruing from formalization.[xv] In order to promote a more supportive environment for business, Governments have been at work on reforms designed to address the key obstacles.

3.2.1 Ease of doing business

Mauritius continues to lead in Africa, remaining the easiest place to do business in the region, and ranking thirteenth globally. Mauritius improved significantly in the area of construction permits and registration of properties. Streamlined procedures in Mauritius, resulting from the automation of licensing permits, have contributed to major reforms in dealing with construction permits. The submission of business licensing documentation (including, e.g., building and land-use permits and occupation certificates) can now be carried out electronically with the implementation of the National Electronic Licensing System. The country has implemented the Mauritius e-Registry System, through which a national register of immovable properties and statistics on land dispute resolutions are now available publicly. A mechanism for filing complaints has also been implemented. These steps have resulted in improved transparency of information provided by local authorities.[xvi]

Rwanda scores high in the area of starting a business and obtaining credit which has become very easy. Rwanda, Kenya and Zambia all lead in this category and are among the world's top 10 performers.[xvii] Rwanda landed the top spot among the world's reformers following changes made in 7 of the 10 business regulation areas measured by the Doing Business report, which is compiled by the International Finance Corporation (IFC).

> *"With reforms led by the Organization for the Harmonization of Business Law in Africa last year and the Central African Economic and Monetary Community this year, economies in sub-Saharan Africa have demonstrated how regional cooperation can help to effectively improve the business climate."*
>
> *Santiago Croci Downes, Programme Manager of the Doing Business unit, IFC*

Just two procedures completed over three days are required for a Rwandan entrepreneur to start a business. Importing and exporting are more efficient and transferring property takes less time thanks to a reorganized registry and statutory time limits. Investors have greater protection, insolvency reorganization has been streamlined, and a wider range of assets can be used as collateral to access credit.[xviii]

Score Card For Rwanda Doing Business 2020

Each topic is measured out of 100 points

- Starting a business 93.2/100
- Dealing with construction permits 70.6/100
- Getting electricity 82.3/100
- Registering property 93.7/100
- Getting credit 95/100
- Protecting minority investors 44/100
- Paying taxes 86.4/100
- Trading across borders 75/100
- Enforcing contracts 69.1/100
- Resolving insolvency 57.2/100

Compiled by Taarifa (www.taarifa.rw)

Figure VIII: Scorecard for Rwanda Doing Business 2020
Source: *www.Taarifa.rw.*

The Kenya Private Sector Alliance (KEPSA) launched the Micro, Small and Medium Enterprises (MSME) Policy Index in 2019 to provide policymakers and market players with a tool for monitoring and evaluating progress achieved in implementing policies designed to support MSMEs. This MSME policy index is the first of its kind in Africa and borrows from the best practices implemented by Association of Southeast Asian Nations (ASEAN) countries. Its main objective is to ensure that SME policy issues are included in the business environment reform agenda and that the year-on-year improvement of Kenya's World Bank Ease of Doing Business ranking is benefiting businesses of all sizes across the country.

The Index is structured along eight policy dimensions and contains recommendations that are highly necessary for MSME development across the policy space, legislation, regulations, programmes and MSME support systems. It is intended to support the Government in setting targets for MSME policy development through identification of strategic priorities for improving the business environment so as to stimulate the growth of MSMEs and the entire economy.[xix]

The Index is derived from a total of 75 indicators. Measurement of the extent to which each policy dimension is supportive or not supportive of MSMEs is dependent on those indicators. The eight policy dimensions are captured in Figure IX.

Figure IX: Dimensions of the MSME Policy Index in support of Kenya's MSMEs

1. Enabling governance and business regulatory environment
2. Reliable infrastructure and access to inputs
3. Human capital and entrepreneurial skills development
4. Access to MSME financing
5. Effectiveness of MSME representation
6. Supportiveness of framework for business development
7. Market linkages and expansion initiatives
8. Innovation, information and communications technologies (ICT) adoption and technology transfer

Source: https://kepsa.or.ke/kepsa-launches-index-to-assess-msmes-policy-framework/.

3.2.2 Registration: single-window business registers and one-stop shops

In general, informality usually results from the erection of barriers associated, among other things, with the cost of registration and compliance and complicated structure of regulations. As noted above, according to the World Bank Enterprise Surveys, the main reasons given by MSMEs for not registering their businesses are the lack of information on how to register an enterprise, the time required to complete the registration process, the taxes that registered businesses would be required to pay, and the perceived lack of benefits accruing from formalization. One-stop shops, where all of the necessary information for MSMEs is made available on a single platform, could contribute positively to their growth and development. Through these platforms, access to information on regulations could be made available to MSMEs at minimum cost. The use of information technology also has great potential to narrow the information gap for MSMEs.

In order to improve the business environment for MSMEs, the Government of India has launched a new process for the registration and classification of enterprises. The new Udyam (MSME) Registration Portal started operations in July 2020, and it is envisaged that the portal will be completely paperless and based on self-declaration. As a result, small businesses will not need to update any documents or proofs for registration, except their Aadhaar (unique identity number). In order to facilitate the process, the ministry responsible for MSMEs has established a single-window system through Champions control rooms which have been set up at MSME development institutes across India and at district industry centres.

It is envisaged that this will alleviate the problems faced by MSMEs in managing multiple documents and registration processes, and help save on time and costs. It should also assist the Government in the identification of possible beneficiaries for the various schemes and packages announced for MSMEs, such as collateral-free credit and subordinate debt for distressed enterprises to enable them to access benefits directly.[xx]

As part of efforts to enhance the ease of doing business in Nigeria and facilitate operations and simplify procedures for MSMEs, the federal Government has initiated the process of opening one-stop shops for the registration and administration of MSMEs across the country. The aim of the one-stop shop approach is to bridge the information and investment gap subsisting between micro- and small investors and government regulatory agencies.[xxi] It is envisaged that the initiative will make it possible for local entrepreneurs to interact with relevant regulatory agencies in one location and will provide them with opportunities to update their knowledge on current practices in business. It should also ensure that collaboration of the agencies on improving the ease of doing business in the country will be seamless. This is key since it is estimated, based on available data that more that 17 million MSMEs currently operate in Nigeria.[xxii] Creating the right environment for their growth and for the realization of their full potential is therefore likely to have a positive impact on the economy.

3.2.3 Taxation

The overall objective of simplification of taxation procedures for MSMEs in developing countries is, generally, to facilitate voluntary tax compliance and to remove obstacles in moving towards business formalization and growth.

South Africa has enjoyed steady success in broadening its tax base for small businesses. Various legislative measures were enacted to provide them with preferential tax treatment for. In the South African "2018 Tax Statistics" report, it was noted that as at 30 June 2018, 768,687 companies (714,422 as at 30 June 2017) had been assessed for taxation, of which 143,768 of the companies assessed (129,867 as at 30 June 2017) were small business corporations which paid taxes at the preferential graduated income tax rate, instead of at the fixed corporate tax rate of 28 per cent,[xxiii] This attests to the fact that an increased number of small businesses are utilizing the preferential tax regime. Notwithstanding these signs of progress, taxpayer education and the cost of tax compliance remain significant challenges for MSMEs, as, often, they simply do not have the necessary staff resources and skills to fully comply with all of their tax obligations in a timely manner.[xxiv]

The Government of Zimbabwe, which has adopted an inclusive approach, is working with the Zimbabwe Revenue Authority, local authorities and MSME associations to promote the formalization of the informal sector and to create an appropriate tax and accounting regime for MSMEs.[xxv]

Tax reforms introduced in Colombia in 2013 brought major changes to the Colombian system. The main objective of the reforms was to create jobs and reduce inequality. The reform was also intended to promote formal employment. The reform eliminated para fiscal contributions to a number of institutions as well as part of the contributions paid by employers to social security, in the case of employees receiving salaries below 10 minimum wages. To offset the decline in revenues stemming from the institution of these reforms, a CREE ("fairness") tax was introduced, comprising a 9 per cent tax rate on corporate profits until 2015, followed by an 8 per cent rate from 2016 on. This decreased the fiscal burden on employment while increasing the fiscal burden on business revenue, which is supposed to be beneficial for MSMEs. The tax reform significantly changed the Colombian social security model, as health care is now financed primarily through general taxes.[xxvi]

In some emerging economies, certain exemptions are made for targeted MSMEs. For example, in China, tax policy has been designed to encourage the financing of MSMEs by providing business tax exemptions for corporations that guarantee loans to MSMEs. Also, tax deductions are awarded to market entities and venture capitalists who invest in MSMEs to the tune of 70 per cent of the amount of investment.[xxvii]

3.3 Supply and value chains

Supply and value chains can provide market opportunities for informal enterprises. These enterprises could provide services for the bigger companies which require reliable and standardized supply chains for the production and distribution of their products and services. A significant number of multinational companies working in sectors such as power, tourism and hospitality, agribusiness and forestry, and telecommunication sectors, among others, have requirements for enterprises which constitute integral components of their value chains, including the requirement that, for example, the business be registered. Partnerships could be forged between large corporations and small and medium-sized informal enterprises, so that the SMEs might be provided with capacity development and market opportunities. These opportunities could serve as incentives for the firms to register and become part of corporations' value chains. In the process they could expand their clientele, secure new contracts and gain access new markets. The removal of constraints associated with the process of business registration is a factor crucial to incentivizing enterprises to register their business and become part of the corporate supply chain.

In Sri Lanka, a business association of motorcycle rickshaw drivers was instrumental in helping several rickshaw entrepreneurs obtain the licenses, training and connections needed to integrate their operations with those of a large luxury hotel which had an interest in providing its clients with reliable local transportation services.[xxviii]

Value chains can also be a means of facilitating and extending access to financing. One example of the innovative use of a value chain for this purpose is provided by the United Republic of Tanzania, where TechnoServe, a market facilitator, helped smallholder farmers in an agricultural value chain (AVC) establish Kilicafe, an organization owned by 9,000 smallholder farmers. This organization works with local and international financial institutions to design financial products that serve those in the value chain. These products range from short-term input credit and pre-financing sales to multi-year loans used by farmers to invest in centralized processing facilities. Credit is guaranteed through a variety of innovative methods, including private guarantee funds, warehouse receipts and forward sales to specialty coffee buyers.[xxix]

3.4 Access to finance

MSMEs face multiple hurdles in their efforts to establish and grow sustainable enterprises, with the lack of appropriate forms of finance often ranked as the most serious constraint on achievement of their goals. In developing countries, credit provided to the private sector as a share of GDP is well below the average in high-income countries and the lack of a well-developed financial infrastructure pose challenges for both credit providers and the enterprises that use the credit. The situation in Africa is particularly challenging. The MSME finance gap for sub-Saharan Africa is the highest in the developing world (51 per cent in 2017) according to IFC (Closing Africa's MSME Finance Gap). Yet, the informal sector contributes an estimated 38 per cent of sub-Saharan Africa's GDP, with the implication being that the overall finance gap is probably higher.

It is estimated that there are approximately 40 million formal and informal SMEs in sub-Saharan Africa, of which an estimated 55 per cent are unserved or underserved by the formal financial sector. These numbers reflect the reality of financial systems in most of Africa - systems that provides only limited and costly financial instruments to SMEs, and that lack a private equity market and long-term financing tools.

Globally, SME access to finance remains a high priority in terms of government policy responses and interventions.[xxx] These policies focus on a wide range of interventions: increasing the reach of the credit provider market (entailing extending credit guarantee systems, increasing public support for equity finance instruments and supporting digital forms of access to credit), supporting the development of tools for increasing the efficiency of MSMEs (entailing implementation of online tools and addressing the issue of delays in payment to MSMEs) and increasing non-financial support (entailing improving financial literacy and business skills).

3.4.1 Secured lending practices: collateral registry

Secured lending practices are discussed within the context of a situation where in developing economies, almost 80 per cent of the capital stock of most businesses comprises movable assets, such as machinery, equipment and receivables. Smaller enterprises, in particular, are less likely to have access to fixed assets such as a plot of land or a building. This being the case, movable assets are the main type of collateral that can be offered by MSMEs in order to secure financing. However, where legal and institutional protections are inadequate, banks are often reluctant to accept movable assets as collateral. Women are especially disadvantaged given their lack of access to traditional forms of collateral.

A collateral registry, which lists and records existing security interest in movable assets, can help to protect the rights of creditors in secured lending. Such registries are publicly available databases of interests in or ownership of assets. A comprehensive and integrated secured transactions regime requires a well-functioning collateral registry. This mechanism supports the legal framework of security rights in movable assets by recording claims on the assets and establishing priority, based on the time of registration. In Africa, Ghana, The Gambia, Liberia, Malawi, Nigeria and Zambia have launched modern collateral registries, i.e., a centralized facility, where any interest in an asset is noted and available as part of online public access to the registry.[xxxi]

3.4.2 Mobile money

Mobile money is positioned to aid informal MSMEs in their path to formalization by increasing their productivity and profitability, improving access to credit and enabling the growth of MSMEs already within the formal sector. As of

2017, approximately half of informal business owners globally and in developing countries had a mobile money account or an account at a bank or other formal financial institution. Nearly 80 per cent of informal business owners in developing countries have a mobile phone. In countries such as China and Kenya, almost all informal business owners own a mobile phone. Moreover, approximately 1 in 5 informal businesses in developing countries use mobile phones or the Internet to make payments. Mobile phone and Internet payments are higher in sub-Saharan African countries where there is strong mobile money penetration. For example, in Kenya, 78 per cent of informal business owners make such payments, while in the United Republic of Tanzania and Zimbabwe, the share is slightly over 50 per cent.

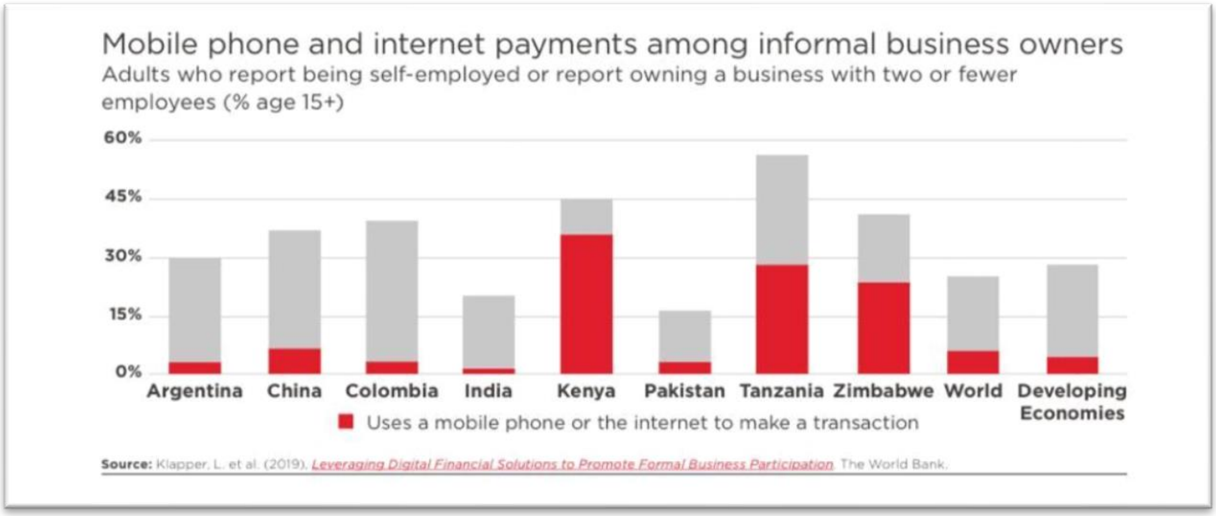

Figure X: Mobile phone and Internet payments among informal business owners, selected countries
Source: GSMA, « Mobile money: driving formalisation and building the resilience of MSMEs", June 2020. Available at www.gsma.com/mobilefordevelopment/wp-content/uploads/2020/06/Mobile-Money-Driving-formalisation-and-building-the-resilience-of-MSMEs.pdf.

Mobile money has played an important role in helping MSMEs overcome the financial exclusion that stems from operating in the informal economy. According to GSMA), the findings of recent research centred on two sub-Saharan African countries found that 80 per cent of MSMEs already owned a mobile money account and 83 per cent were using personal mobile money accounts for business needs. By enabling access to financial services, mobile money is positioned to offer three main solutions to the challenge of aiding informal MSMEs on their path towards formalization, namely, increasing productivity and profitability, improving access to credit, and enabling the growth of MSMEs already in the formal sector.

The adoption of digital technologies has been recognized as an important remedy for the financial exclusion experienced by those working in the informal economy. It represents an important step in the transition to the formal sector. Recent research has found that the adoption of mobile financial services decreases the size of the informal sector by up to 4.3 percentage points of gross domestic product.[xxxii] The view that digital financial services can accelerate the transition from informal to formal economic activity is shared by the World Bank Group, the United Nations Secretary- General's Special Advocate for Inclusive Finance (UNSGSA) and the G20 Global Partnership for Financial Inclusion (GPFI).

According to the *G20 Policy Guide on Digitisation and Informality*, access to formal financial services can reduce informal economic activity over the long term by increasing the credibility and productivity of MSMEs, helping them overcome the cost of entry into the formal sector, and reducing the opportunity cost of operating within the informal sector.

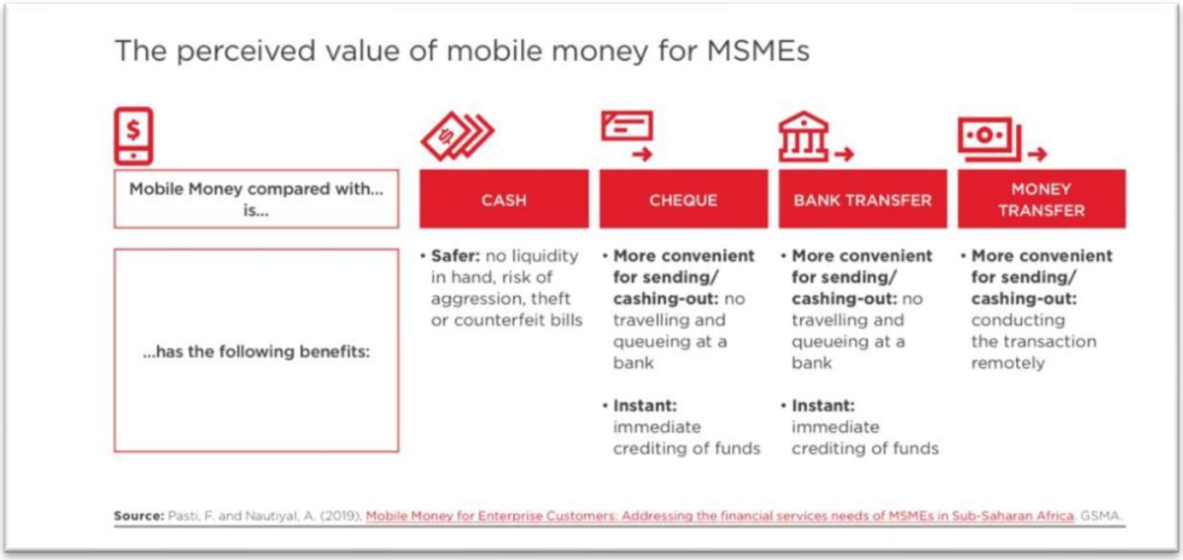

Figure XI: Perceived value of mobile money for MSMEs

Tools that facilitate access to formal financial services are therefore in high demand in the region, and new technologies are playing a role. Mobile banking platforms, such as M-Pesa in Kenya, help individuals and enterprises access fast and reliable payment systems. Since 2014, the share of adults in sub-Saharan Africa with a mobile money account has grown about twice as much as the share of bank account owners. Mobile money is used widely for services such as receiving or sending funds.

3.4.3 Public-private partnerships (PPPs)

The Regional MSME Investment Fund (REGMIFA) for Sub-Saharan Africa is a debt fund with a focus on financing microfinance institutions, local commercial banks and other financial institutions that serve MSMEs. The Fund, which was launched in 2010, is a multilayered vehicle structured to attract both public and private investors that are seeking to promote impact with a risk-adjusted return. It is a public-private partnership which currently operates in 19 countries in sub-Saharan Africa, of which 13 belong to the least developed country category. Since its inception, REGMIFA has originated US$ 413 million for investments in sub-Saharan Africa and impacted more than 170,000 microentrepreneurs. A dedicated Technical Assistance Facility runs parallel to the Fund, providing tailor-made technical and institution-building support to REGMIFA partner institutions.[xxxiii]

In February 2020, Netherlands-based ASN Bank invested US$ 16.2 million in debt in REGMIFA to foster development in sub-Saharan Africa through employment creation, income generation and poverty alleviation. ASN Bank is the first private investor to join REGMIFA that endorses the mission of financing small businesses and creating jobs in sub-Saharan Africa. The investment, which brings the fund's total assets to US$ 144.4 million, will finance loans to businesses and households through selected financial institutions in sub-Saharan Africa.

3.5 Human capital development

Informality has been tied to a lack of education (both formal and entrepreneurial) and lack of skills, which creates a vicious cycle of persistent poverty and vulnerability. This has been amply demonstrated through the impact of COVID-19 on microenterprises. Further, strengthening the human capital base through education and skills development is seen as a means of increasing productivity, and as having the potential to increase the number of decent jobs and thereby lift key segments of the population out of poverty.

To meet the growing demand for skills, many developed and developing countries are adopting policies that clearly focus on skills development and technical and vocational education and training (TVET), as a means of ensuring that people will be more employable - and more productive - once they are employed or become self-employed.

3.5.1 Technical and vocational education and training (TVET)

TVET policies cover the preparation of tomorrow's workforce for competitive labour markets, most of which are dominated by MSMEs. Innovation in MSMEs is crucial to their success and sustainability. Enterprises characterized by innovation are more likely to survive in the market than enterprises that do not innovate. Innovation should be the responsibility not only of entrepreneurs but of all employees, particularly in high-tech enterprises where many are typically TVET graduates.

Currently, TVET is linked mostly with entrepreneurial training, as evidenced, for example, by the focus of Kenya's Technical, Industrial, Vocational, and Entrepreneurship Training (TIVET) programme.

At the regional level, the African Union (AU), recognizing that acquisition of employment skills is a key driver for economic development and growth, has developed a continental strategy for technical and vocational education and training (TVET). The development of higher-level skills is viewed as necessary for the adaptation of technology and innovation, transformation of national production systems, and industrialization of the African economies. Moreover, the availability of a skilled workforce is, inter alia, a major attractor of foreign direct investment (FDI). TVET is also seen as key to the transition from informality, taking into account the fact that while about 10 million-11 million youth enter the job market annually, and only 3 million formal jobs are created every year in Africa.[xxxiv]

The MSME Academy has three components:

- An informational webinar with invited speakers
- A series of virtual instructor-led training programmes
- Mentorship of MSMEs.

"*In this continent where the majority of the countries are low income and middle-income economies, where youth account for almost 60% of all of Africa's unemployed, the contribution of MSMEs and informal enterprises to the GDP growth and employment creation is fundamental. As the continent faces the socio-economic uncertainties brought about by the outbreak of COVID-19, the AUDA-NEPAD MSME Academy which is delivered in partnership with Ecobank, aims to foster resilience and the survival of MSMEs' in these critical times*."

AUDA-NEPAD Chief Executive Officer Dr Ibrahim Assane Mayaki

The Academy has country-specific content with world-class pan-African design to ensure that the right balance is struck between local realities (challenges and opportunities for MSMEs) and a structured pan-African approach for the sustainability and scalability of the initiatives.

3.5.2 Tech hubs and co-working spaces

MSMEs in Africa are now using new approaches to workforce development such as tech hubs, disruptive labs and co-working spaces to strengthen their capacities and reduce the costs of running their enterprises. The disruptive labs provide a networking mechanism to enable entrepreneurs to learn from each other in their areas of expertise. The labs also serve as hubs for nurturing creativity and innovation. They provide capacity development services, such as training, mentorships and business development services (BDS), among others.

In this context, the United Nations Development Programme (UNDP) accelerator labs platform provides the organization with a new way of working on development. UNDP is using these labs as a means of reimagining development for the needs of the twenty-first century. The aim is to transform current approaches through the introduction of new services, based on evidence and practice, and through acceleration of the testing and dissemination of solutions. It is envisaged that together with partners, the Labs will analyse challenges within local contexts in order to identify connections and patterns that open up new avenues of work, with a focus on effective action in addressing development challenges.[xxxv]

The use of co-working spaces is on the rise in Africa especially among start-ups. They provide services, based on demand, related to, inter alia, office work, conferencing and meetings, as well as capacity development services including BDS. These venues are well equipped to serve as modern office spaces with all of the requisite amenities, such as Wi-Fi and access to printing and photocopying. They are much cheaper to operate than high-cost regular offices, thereby alleviating the burden of meeting such costs. They are therefore highly suitable for start-ups and entrepreneurs. They are also useful as a support for informal MSMEs in their transition to formality.

The number of co-working spaces in Africa is on the rise. There are currently over 250 such spaces, 80 per cent of which were established in the last three years. According to research carried out by Co-working Africa, the c-working business is expected to experience exponential growth which could be attributed to the fact that 70 per cent of the total population of Africa are millennials, in addition to the fact that many opportunities are currently flooding the continent. In this regard, co-working is now perceived as a solid foundation for the establishment of local ecosystems made up of entrepreneurs who are seeking opportunities to start their careers and take the lead in shaping modern digital-friendly and tech-savvy economies.

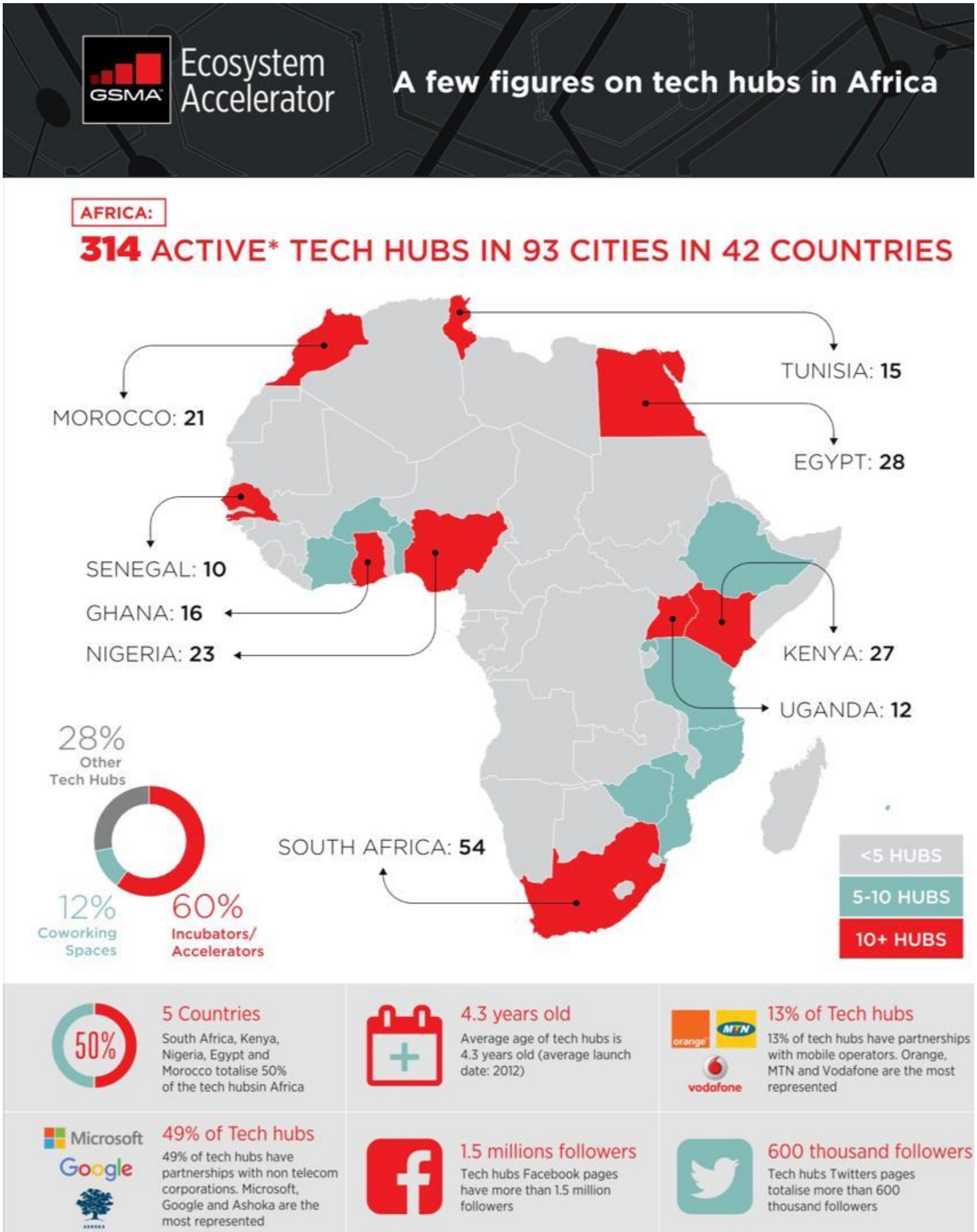

Figure XII: Figures for tech hubs in Africa
Source: GSMA.

The co-working spaces in Africa afford up-and-coming entrepreneurs with access to infrastructure, knowledge and skills at minimal cost.[xxxvi] They also provide opportunities for employment. Mobile technologies have led to a considerable improvement of connectivity in Africa, which has exerted a positive impact on arrangements for facilitating the development of shared value systems and spaces where local entrepreneurial communities can develop. The fact that the African co-working ecosystem continues to grow provides an opportunity for strengthened collaboration at the regional and global levels. Notwithstanding, the co-working community continues to face a number of key challenges such as the lack of both quality infrastructure and strong Internet connectivity.

3.6 Social dialogue

Formalizing the informal economy in a sustainable manner is pivotal to reaching the objectives set out in the 2030 Agenda for Sustainable Development. Social dialogue can play a central role in this regard and can contribute to this formalization process and to achieving the related Sustainable Development Goals (SDGs), notably SDGs 1, 5 and 8.[xxxvii] The Trade Union Development Cooperation Network (TUDCN) has been at work exploring the role that social dialogue plays in achieving the SDGs. More specifically, its research has focused on how social dialogue has contributed to the formalization of the informal economy in Kenya, Argentina, Costa Rica and the Philippines.

In Kenya, through the impact of social dialogue on sustainable development and on the transition to the formal economy, there have been some achievements in certain groups of informal economy workers such as domestic workers, street vendors and tea and flower pickers. Social dialogue enabled the agreement on a minimum wage increase of 18 per cent for domestic workers in the biggest cities of the country, which resulted in their monthly salaries' going from US$ 30 to US$ 130. Social dialogue also made it possible to formulate five labour laws which apply to all workers, be they informal or formal, signifying that they have equal rights and should receive equal pay for work of equal value. The tea and flower pickers' union negotiated a collective bargaining agreement with the sector's employers, resulting in a 23 per cent pay rise for the workers and a 28 per cent house allowance increase.[xxxviii]

In Argentina, the use of social dialogue to address informal economy issues resulted in a 1,440 per cent increase of the minimum wage for informal workers between 2003 and 2013. Undeclared employment plummeted from 48.3 per cent in 2003 to 33.5 per cent in 2017. Further, the number of self-employed workers contributing to the social security system rose to 2.7 million in 2013. This trend of social improvement also reached the sphere of collective bargaining agreements: between 2011 and 2017, over 33 collective bargaining agreements referred to the informal economy.[xxxix]

4. Conclusions

Governments around the world realize that SMEs constitute the battleground on which the pandemic and the broader economic recession most directly interact. In addition to addressing the health crisis, they have scrambled to alleviate the impact of the coronavirus disease (COVID-19) pandemic on small businesses, introducing policies to help those enterprise scope with short-term financial risks and long-term business consequences. This will, it is hoped, reduce layoffs, prevent bankruptcy, encourage investment and help economies get back on their feet as soon as possible, as the crisis abates.

The pandemic has also brought to light the importance of formalization, as informal MSMEs have been disproportionately affected in Africa. Such vulnerability not only affects the MSMEs themselves, but has national and regional implications as well. In this regard, the African Continental Free Trade Area (AfCFTA) provides a major opportunity for countries to boost growth, reduce poverty and broaden economic inclusion. If the AfCFTA is implemented fully, its operation could boost regional income by 7 per cent, or $450 billion; speed up wage growth for women; and lift 30 million people out of extreme poverty by 2035. Achieving these gains will be particularly important given the economic damage inflicted by the COVID-19 pandemic, which is expected to cause up to $79 billion in output losses in Africa in 2020.[xl] MSMEs are a critical player in AfCFTA implementation, as they are essential for supply and value chains. This calls for greater emphasis on - and investment in - the formalization process.

There is a need for faster policy implementation to remove the main roadblocks to Africa's economic development but progress remains slow in improving quality of education, building infrastructure, adopting new technologies, deepening capital markets and accelerating the rate of structural change. Modifications in all of these areas require long-term processes, whose impact will be discernible only after many years. At the same time, there is a pressing need to offer better opportunities to the large and growing cohorts of Africa's young people.

Greater efforts and greater emphasis should be focused on policy implementation, rather than on policy definition, in order to overcome one of the main weaknesses of Africa's development programmes. Strengthening institutions is a necessary precondition for enabling adoption of more-incisive policies and their faster implementation and for sparking private sector action. Despite the progress that has been made in some countries, the average quality of public and private institutions remains low, which acts as an overarching hindrance to the implementation of reforms. The execution of development programmes in Africa in general, and in fragile and conflict-affected States in particular, take a long time. Against this backdrop, better public and private institutions as well as coordination and dialogue are needed to speed up the reform process.[xli]

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