

ARTICLE

ALL ON BOARD!

Integrating Small and Medium Scale Enterprises into the mainstream economy

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“The Mystery of Capital”, a book written by the Peruvian Economist Hernando De Soto, immediately comes to mind anytime one considers Ghana’s fiscal situation. This book examines the importance of the extralegal sector to the economy. The extralegal sector is made up of assets, properties and businesses that fall outside the legal or formalized record systems, restricting the use of these assets in the creation and expansion of capital. This classic book stresses how lack of representations – processes to represent assets and create capital – has led to many third world economies being undervalued. According to De Soto (2000), the inability of developing countries to fully integrate extralegal sections of society into the mainstream economy is central to addressing the problem of value creation that has longed plagued many developing countries.

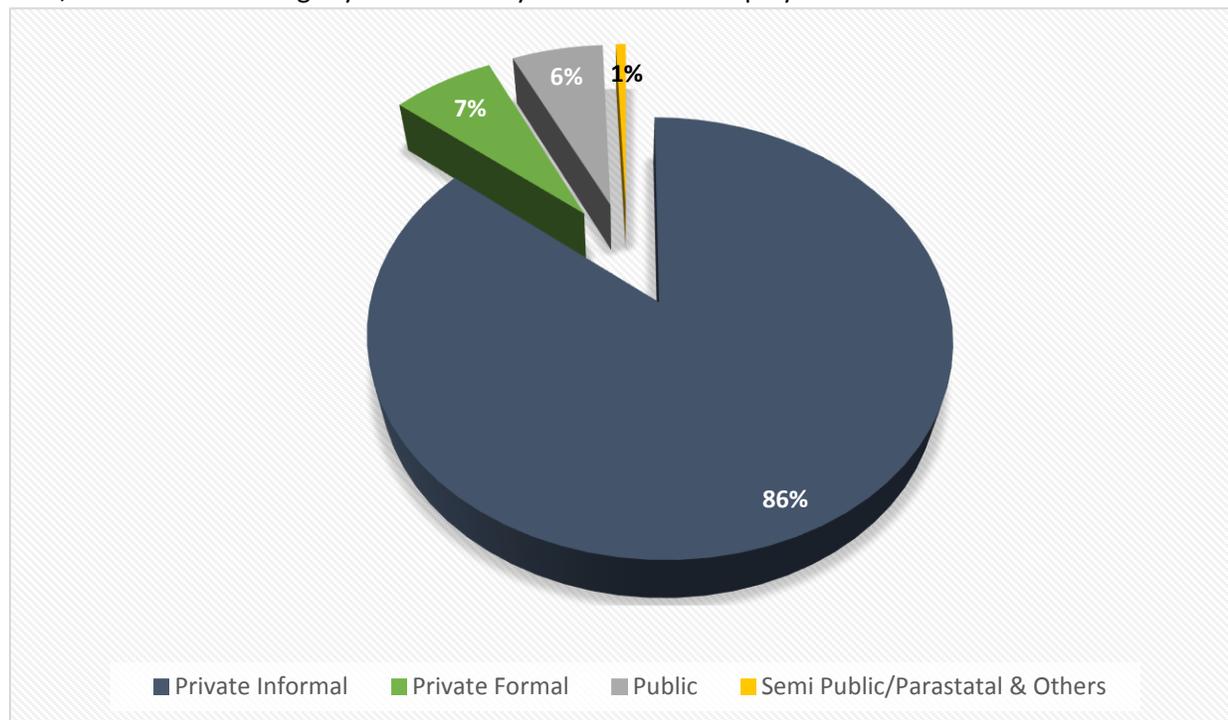
In Ghana, the extralegal sector can be likened to the informal sector where most **Small and Medium Scale Enterprises** (SMEs) are found. Over the past two decades, successive Governments have recognized the need to integrate the informal sector into our legal and formal systems. The advantage of having such a system is that it makes information readily available, facilitates trade and supports effective planning and policy implementation. Now more than ever, Government and other stakeholders would need to find a way to document the activities of SMEs in a manner that ensures a win for all parties. The recurring revenue shortfall situation, pressing need for massive capital infrastructure projects, unemployment, low economic growth rates and the uncertainty related to over-reliance on export commodities to drive long-term growth are some of the reasons that make it imperative for Government to consider alternative (and perhaps more aggressive) programs that will provide the right incentives for the integration of informal sector businesses into the formal economy, if we are to succeed in our efforts at creating value and further diversifying the Ghanaian economy.

SMEs are the real engine of growth

There is no dispute surrounding the assertion that the private sector is and will increasingly become the propeller of economic growth in any modern society, especially as government budgets become inadequate for the many emerging economic and social needs of its citizens. It is also very well documented that SMEs contribute significantly to employment in developed countries and regions. SMEs create new jobs, expand the tax base and are drivers of innovation. Depending on the jurisdiction in question, SMEs are defined based on the number of employees, turnover or the size of business’ balance sheet. Countries and regions such as the United States of America, China, Japan, Malaysia, Korea and the Eurozone benefit enormously from SMEs. According to the European Union (EU)¹, SMEs represent 99% of all enterprises in Europe. In the past five years, they have created around 85% of new jobs and provided two-thirds of the total private sector employment in the EU. The European Commission considers SMEs and entrepreneurship as key to ensuring economic growth, innovation, job creation, and social integration in the EU.

Ghana's 2010 Population and Housing Census (PHC)

According to the PHC conducted in 2010, 64.8% of economically active persons in Ghana were self-employed. Also, females are slightly more likely to be self-employed than males. The census confirmed



the already accepted belief that the private sector is the largest employer in Ghana. The private informal sector accounts for 86.1% of total employment in Ghana, with the private formal sector contributing 7.0% (See chart). The public sector accounts for 6.3% of total employment while semi-public, parastatal and others account for the rest. Even though these are not current figures, the freeze on public sector employment since 2010 may imply an even bigger magnitude of private sector jobs, both formal and informal.

Ghana's Fiscal Imbalance and the problem with low hanging fruit

The 2017 Budget Statement puts Ghana's fiscal deficit for 2016 at 8.7% of GDP as against a target of 5.3% on a cash basis. After the fiscal deficit rose to 11.8% in 2012, Government made attempts to reduce the deficit situation mainly by ramping up revenue mobilization efforts and managing public expenditure. Unfortunately, the situation in Ghana is that rather than aggressively growing the revenue base in a manner that maximizes productivity and discourages tax evasion, a heavier tax burden falls on large firms and the small proportion of the citizenry employed in the formal private and public sectors.

One would argue that if the earnings of certain individuals and companies provide easy targets for tax authorities, we should increase taxes in those areas. The problem that would create, and indeed has been creating in Ghana, is quite obvious. The current situation in this country is that new and higher tax rates are levied on the same "obedient" tax payers, mostly in the formal sector, who face reduced disposable incomes. Increasing corporate taxes is another easy alternative, but again that provides the incentives for large firms to find innovative ways of avoiding taxes. In an increasingly globalized world, multinationals continue to find new territories to conduct business in cheaper ways and if a country's tax regime is considered unfavorable, such firms are likely to move away from or maintain a limited presence in high tax regimes. It is important for

governments and tax authorities to know the optimal level of tax for individuals and firms beyond which any increases in taxes would be counterproductive.

Widening the tax net is the most sustainable way of ensuring that Government mobilizes enough revenue in the current and future periods. It appears to be a herculean task, but it is possible for Government to formalize and properly document the operations of businessmen and businesswomen who deal in tiles, upholstery, medical products, agricultural products, spare parts, second-hand clothing and meat products among others. Government and the private sector can adopt a strategy that has far reaching benefits beyond just tax mobilization, to develop integrated markets, support business expansion, job and wealth creation and boost economic growth.

What can be done?

Gather data on all businesses

First of all, there is no way to come up with a proper plan to help develop the efficiency and capacity of SMEs without gathering relevant data in relation to those businesses. As a starting point, all businesses that generate monthly income beyond a certain threshold say, GH¢1,000 must be compelled to provide information about their business – ownership, location and cash flows among others. As Mr. De Soto pointed out, without an implicit legal infrastructure backed by accurate data and representations that assigns rights to assets, it is practically impossible to have a functionally integrated economy that is able to create capital and facilitate trade beyond narrow local circles.

Provide Incentives

From previous experiences, the average Ghanaian would not readily volunteer information pertaining to his or her business. To deal with this challenge, Government and its partners must provide the right incentives that will make it worthwhile for business owners to willingly volunteer and provide basic details about their businesses. The incentives can include the provision of book-keeping and professional services free of charge for the micro business and charging a reasonably low fee for the same services that is provided for SMEs. The Ghana Revenue Authority (GRA) ² recognizes the fact that many businesses do not keep proper books of accounts. An intervention that requires businesses to integrate into a wider economy in exchange for services that will make SMEs more efficient and profitable is appropriate. The spin-off effects of ensuring that all businesses at the very least prepare ledgers and trial balances, and in more sophisticated cases income statements, balance sheets and cash flow statements, provide significant benefits to the SMEs themselves. Such businesses will have improved access to cheaper loans, especially if they have predictable cash flows, and assets belonging to the business are documented and fungible. With more businesses having traceable assets and well-documented operating histories, lending rates in the general economy are likely to drop in line with a reduction in SME lending risk.

Create Jobs and Career Opportunities

Who is going to provide the professional and book-keeping services for the many informal businesses throughout the country? How will these people be compensated? How sustainable will such an intervention be? These are legitimate questions, and the answer lies in a scheme that many argue has outlived its usefulness – the National Service Scheme. There are many young Ghanaians today who study business related and accounting courses. Many of such students graduate yearly and are enrolled on the National Service Scheme. Unfortunately, these graduates are posted to assist in areas where their skills are not adequately utilized. A

deliberate attempt to use business graduates for this SME capacity building program will ensure sustainability of this program since it provides a constant pool of trained individuals to help gather information, document business processes and prepare books of accounts for SMEs. These graduates will effectively be launching a career in a specialized area that will enhance their future job prospects and enable them learn on-the-job. The Government and the Institute of Chartered Accountants Ghana could offer a short 3-week training program for the graduates who are to facilitate the implementation of this program and award Certificates in SME accounting to them, which would be a good incentive for the best students to volunteer to join. These graduates would of course earn monthly stipends in the form of NSS allowances.

Ensure businesses comply

Ghana is said to be a country that has all the right laws. For such a comprehensive integrated program to work, Government will have to be active in ensuring compliance through, among others, random inspections and checks to enforce existing legislation that requires registration of businesses; penal charges on businesses that fail to provide the required details; and special identification that facilitates provision of financial assistance, credit and other professional services from Government and its financial partners to qualified SMEs.

The cost of non-compliance must be high. For instance, if failure to comply with such a directive means that businesses that import goods cannot clear them at the ports, the incentives for compliance would have been established. Ensuring that all other businesses comply with same directives will curb any potential shortage of essential goods. Therefore, Government will have to go beyond the measures mentioned above and actually compel businesses to comply in a manner that will encourage others to do same. If through association and compliance with this elaborate Government program, an agro-processor in Ghana can export his/her produce to meet growing demand in the sub-region because of access to cheaper funding and support at the ports in getting goods to their final destination, there is a great likelihood that many other businesses will attempt to replicate this success. The testimony of business owners that have benefited from the program provide a stronger case for compliance than any Government action.

Other benefits

This program would lead to a deepening of the entire SME business value and ensure financial inclusion. Accounting firms and banks would create SME desks to provide parallel services aside from the basic book-keeping services. Government will provide through the National Service Scheme. SME financing would likely improve and investors would have adequate assurance to move their funds into this sector which has been described as very risky. This, in itself, will help better allocate the resources of the country as market forces determine the most efficient businesses even within the broad SME value chain. Ghana is likely to secure funding and technical assistance for this program since it is aligned with the goals of many of the developmental agencies operating in the country.

Government can facilitate trade in Ghana among local SME business owners by organizing trade fairs for specific products and services at ideal locations. For local business owners who are compliant and have potential to scale up, Government can support them in visa applications to attend international trade fairs and help resolve other issues that may hinder entry of local businesses into the international markets.

Government can again provide preferential treatment for complaint businesses when it comes to clearing goods at the ports and also provide publicity for complaint businesses using the humongous state resources at its disposal – the GIPC, brand Ghana office and other “pro-Ghana” trade and investment offices can champion this.

A simple online portal can be created that will link buyers and sellers, more like what is done on tonaton.com or olx.com. This can help track trade volumes as orders and payments will be made online, further improving data collection, deepening financial inclusion and convenience of business transactions.

As a revenue generation measure, Government could publish reports, journals and magazines on SMEs for use by investors. Currently, information on say the vehicle repair business at Suame Magazine is fragmented and sometimes plainly inaccurate. With people on the ground who touch base and understand all facets of key businesses and document their activities thereof, accurate information would become available.

Ethical Consumerism is a concept that advocates for purchase of goods and services that have positive social and environmental impacts and shunning products and services that are considered to have a negative impact on society. If as a country we all commit ourselves to such a program and commit to making purchases from businesses that are compliant to this initiative, remarkable gains would be made.

What is being done?

Some of the ideas put forward in this piece are being implemented at one level or another, albeit not in a cohesive and focused manner. Also, because there is little ambition for inclusion and integration of the extralegal sector into the mainstream economy, the successes have not even been evaluated. This Government has decided, as a matter of priority, to revive the National Identification Scheme in order to rope in the economically active but undocumented citizens and the informal sector of the economy, thereby broadening the tax base and accelerating financial inclusion. This forms part of a broader drive by the Government to facilitate financial inclusion at all levels in order to ensure economic growth, poverty reduction and job creation. Government's decision to roll-out a national digital addressing system to provide unique addresses for all properties in Ghana would also be useful in assigning property rights and further broadening the tax base by identifying the entities on whom the property tax incidence should fall. These measures could prove to be the game-changers that would lead to the better representations Mr. de Soto writes about in order to create value through a more cohesive, legally enforceable and economically efficient property rights and trading system.

Conclusion

This policy would be a comprehensive and sustainable approach to addressing the problems of revenue shortfalls, unemployment, low financial intermediation and inadequate data on businesses. We can learn from Europe where the EU takes direct and specific initiatives in creating business friendly environments, promoting entrepreneurship, ensuring inter-connection, facilitating access to finance, providing general support services, and ensuring competitiveness and innovation. We need to get this right.

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