

**INVESTIGATION OF FACTORS WHICH CONTRIBUTE TO THE HINDRANCE OF  
SMALL MEDIUM ENTERPRISES (SMEs) FORMALISATION IN CHILENJE  
MARKET OF LUSAKA DISTRICT**

**BY**

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**A DISSERTATION SUBMITTED IN PARTIAL FULFILMENT OF THE  
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MANAGEMENT AND ENTREPRENEURSHIP**

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## DECLARATION

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# APPROVAL

This Dissertation by **Hastings Chijikwa** is approved as a partial fulfilment of the requirements for the award of the Degree of Master of Science in Innovation Management and Entrepreneurship.

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## ABSTRACT

The formalisation of Small and Medium Enterprises (SMEs) is key for the development and growth of businesses and the economy. The aim of the study was to investigate factors which hinder SMEs formalisation in Chilenje Market of Lusaka District. Research objectives were to identify factors that promote SMEs to operate in the informal economy; to analyze the competitive advantage that formal SMEs have over informal SMEs; and to find out if the legal environment supports informal SMEs transition to the formal economy. The study employed a parallel convergent mixed methods design for easy merging of quantitative and qualitative. Quantitative data was collected by using the questionnaire while qualitative data was collected through interviews. Quantitative data was analyzed by using the Statistical Package for Social Sciences (SPSS) while qualitative data was analyzed by using themes and contents in which similar items or themes are grouped together from many voluminous words. The study achieved all its objectives and concluded that the level of education for enterprise owners; awareness of government services; awareness of government services and the procedures involved in accessing government support; cost of formalisation for registered businesses; levels of satisfaction for government services; and laws and policies on enterprise formalisation were directly linked to enterprise owner`s decisions to either formalise their businesses or not. The study recommended that the government should consider offering business training for owners of SMEs for them to be able to make well-informed decisions that can improve and lead to business growth. The study recommended that the government should provide incentives to financial institutions that provide affordable credit for SMEs and start-up businesses; coming with up a communication strategy to improve communication of government support and services for SMEs; and proper implementation of laws and policies that that are meant to support SMEs and facilitate graduation of SMEs from informal to the formal economy.

**Key Words:** Formalisation; Small and medium enterprises (SMEs); informality; formal economy; and business growth.

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Lastly, I take the responsibility for the views expressed in this study and any insufficiencies are attributed to me alone despite input from my supervisor.

## **DEDICATION**

I would like to dedicate this paper to the Almighty God, creator of the universe and everything therein who has been the source of my inspiration, wisdom, knowledge and understanding which have been key to the completion of this research study. I also dedicate this dissertation to my lovely wife Victoria Miyoba Chijikwa who managed to put up with my busy schedule that denied her all the attention she deserved and was a continuous source of my encouragement that helped me complete this research.

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## **LIST OF ACRONYMS**

CDF	Constituency Development Fund
CEEC	Citizens Economic Empowerment Commission
CSO	Central Statistical Office
ILO	International Labour Organisation
MSMEs	Micro, Small and Medium Enterprises
NHIMA	National Health Insurance Management Authority
NAPSA	National Pension Scheme Authority
OECD	Organisation for Economic Co-operation and Development
PACRA	Patent and Company Registration Agency
SMEs	Small and Medium Enterprises
TPIN	Tax Identification Number
ZDA	Zambia Development Agency
ZRA	Zambia Revenue Authority

# **CHAPTER 1**

## **INTRODUCTION AND BACKGROUND**

### **1.0 Introduction**

This study sought to investigate factors that contribute to hindrance of SMEs` formalization in Chilenje Market of Lusaka District. This chapter begins with the background of the research which lays the foundation of the topic and its justification for further inquiry. The chapter will further present the statement of the problem, the aim, specific objectives, and the research questions that are key to the study. It also shows the significance of the study, scope of the study, study limitations and the theoretical and conceptual framework upon which the whole study is based. Finally, operational definitions are also presented.

### **1.1 Background**

Enterprise formalization is critical for the growth of the economy as it leads to creation of formal jobs and expansion of tax base for the government as well as a strategy for poverty and inequality reduction (Maniraguha, 2020). Formalisation is further seen to also benefit entrepreneurs as it allows them to have access to finance which is critical for enterprise growth and increase in turnover and profits.

Informal enterprises are defined as unregistered business entities and enterprises that are not compliant to government regulations such as labour laws and payment of taxes which deny the government the much-needed revenue (Maniraguha, 2020). According to Ackermann et al (2010), an enterprise will only formalise when it reaches a certain turnover because formalisation is the only alternative for an enterprise that is growing as it becomes difficult to hide from state inspection. The report by Ackermann and his colleagues however lacks a comparative analysis of informal enterprise growth rate that warrants formalisation and the growth rate which takes place after enterprise formalisation has taken place.

From a national standpoint, the informal economy presents both benefits and costs for society. On the one hand, the informal economy offers job opportunities and income for the poor population and enables businesses to operate that would ordinarily not be able to operate under the formal economy because of low entry costs for starting up businesses in the informal economy (Ackermann et al, 2010). In as much as the ideal situation is to have most of the enterprises operate

in the formal economy, informal economy is still beneficial as it offers low-cost platform for experimentation of ideas which subsequently lead to business growth.

Assenova (2017) posits that informality has long term negative implications for the economy such as overall economic growth and productivity because the government is not able to provide public goods and services such as road infrastructure, education and law and order because informal enterprises do not pay taxes. Consequently, lack of resources negatively affects business environment, which is not able to support small-scale enterprise development which require friendly environment to thrive. Further, employees for informal enterprises are more susceptible to abuse and do not benefit from government legally mandated benefits such as annual leave, pension, safety etc. On the other hand, formal enterprises are believed to benefit from legitimate market for their products, access to finance, business training and more sales due to consumer confidence in their products (Assenova, 2017).

According to Kenyon (2007), some enterprises prefer staying informal because of costs associated with formalization such as registration fees, taxes, costly health and labour standards and perceived inadequate receipt of public services. Further, some business owners are not motivated to formalize or comply with government regulations if their peers are not compliant and subsequently view formalization as disadvantaging themselves. In addition, collected tax revenues are not a guarantee that governments will use them effectively and efficiently to provide the public goods and services needed for business environments that support development of enterprises. Informality is therefore seen as a coping mechanism in response to a corrupt public service and inefficient regulation. Therefore, bad governance and poor administration capacities seem to be important factors that hinder both enterprise formalisation and development.

Another factor that contributes to failure of SMEs to transition from informal to formal is inadequate management and entrepreneurial skills. Matsongoni and Mutambara (2018) are of the view that managerial competency is key to the growth of the informal SMEs in many countries which can only occur when they are formalized. Matsongoni and Mutambara further observe that inadequate management skills and experience as well as high cost of accounting services are some of the factors that make informal SMEs fail to transition into the formal sector (Matsongoni and Mutambara, 2018).

Fatoki (2014) argues that Government's legal and regulation impacts businesses significantly and determines the environment for trading which can either facilitate transition of SMEs from informal to formal or inhibit SMEs' formalization. Government regulation is believed to be necessary for the provision of trading conditions and development of trust between SMEs and the government which have the potential to encourage SMEs to formalize for easier business growth that is beneficial to both SMEs' owners and the government (Fatoki, 2014). However, deregulation, over-regulation and lack of regulation are not good for business and there is therefore need for government regulations that can support formalization of informal SMEs.

Technological development is one of the key elements and prerequisites for both domestic and international competitiveness of SMEs (Maunganidze, 2013). However, investment in technology is very expensive and individual SMEs can barely afford to fund or pay for technology required to improve production and delivery of goods and services. SMEs' inability to have access to technology demands that they partner and collaborate with established home and foreign businesses for them to access the much-needed technology and this subsequently entails that they also formalize their operations as partnerships and collaboration cannot be established if SMEs are not registered and compliant with relevant government authorities. It is therefore very critical for SMEs to formalize if they are to grow and enjoy services like partnerships and collaborations with other established businesses institutions.

De Mel (2013) is of the view that high levels of corruption and bureaucracy in government agencies may result in collection of low revenues in form of taxation which subsequently translates into poor quality of public services provided and lowers perceived benefits that come with formalization. Poor public services that are a result of mismanagement of public funds may make formal businesses lose motivation to remain formal and some may even decide to exit the formal economy with the view to invest funds that should otherwise be paid in taxes. It is therefore important for the government to prudently use taxpayers' funds so as to instill confidence in formal enterprises and attract informal ones to transition to the formal economy.

## **1. 2 Problem Statement**

In 2015, it was estimated that there were 420 to 510 million SMEs worldwide out of which only 9 per cent are formal and 80 to 95 per cent of the informal SMEs were in low- and middle- income

countries (ILO, 2015). SMEs contribute to economic growth although their potential to generate business linkages and innovation, is hampered by their operations in the informal economy.

As of 2012, Zambia had 1.02 million informal Micro and Small Medium (MSMEs) out of which only 80,000 qualified for taxation most whom were in urban Lusaka and Copperbelt provinces (Shah, 2012). On the other hand, formal MSMEs were 30,000 (Shah, 2012). The alarming levels of informality are also reflected in the number of informal jobs which were estimated at 4,309,006 in 2008, representing 88.9 percent of workers in the economy and in 2012, employees in the informal sector were 4,874,368, which later further increased to 5,229,599 in 2014 (CSO, 2018). A number of studies have been conducted on the challenges that informal enterprises face and a case in point is (Mubita, 2017) who found that informal business entities` challenges include unstable income, poor working conditions, limited access to credit facilities, inappropriate technology, inputs and inadequate business infrastructure. Formalizing the informal economy therefore seems to be viable option to mitigate challenges faced by informal businesses.

Formalizing of the informal economy does not only benefit the government expand its revenue base but equally benefits informal businesses and customers. Customers benefit from informal economy`s formalization in terms of access to insurance cover, enjoy guarantees for products purchased or work done, legal recourse in the event of poor or unsatisfactory job or service done (Williams, 2014b). Benefits accrued to the governments when informal businesses are formalized include broaden tax base as earlier stated above which improves government`s provision of public goods and services and creation of quality employment opportunities for the citizens which consequently lead to improved provision of services in the economy and ultimately economic growth (Jiménez, 2015). It is therefore important to formalize the informal economy because the benefits far outweigh staying informal. Although it is common knowledge that Chilenje Market has several enterprises operating in the informal economy, there are no documented statistics to know the exact numbers. This study therefore aims to investigate factors which contribute to hindrance of SMEs` formalization in Chilenje Market of Lusaka District.

### **1.3 Aim of the Study**

The aim of the study was to investigate factors which hinder SMEs` formalization in Chilenje Market of Lusaka District.

## **1.4 Research Objectives**

The objectives were:

- i. To determine factors that promote SMEs to operate in the informal economy.
- ii. To analyse perceived advantages formal SMEs, have over informal SMEs.
- iii. To establish whether the legal environment supports informal SMEs` transition to the formal economy.

## **1.5 Research Questions**

The research questions of the study were:

- i. What factors promote SMEs to operate in the informal economy?
- ii. How is the competitive advantage of formal SMEs over the informal SMEs?
- iii. What legal environment supports informal SMEs` transition to the formal economy?

## **1.6 Significance of the Study**

Understanding factors that prevent SMEs from formalizing is key to informing formulation of policies and strategies that respond to the needs of the informal economy and make businesses grow. Businesses have high chances of expanding when they are formalized because they can access finance, business trainings, and inspire confidence to the public for their products as well as widening their market. Although the informal sector in Zambia employs the highest number of people, it does not provide quality jobs and employees do not enjoy services like NAPSA contributions, leave days, maternity leave days for women and protection against unfair treatment by employers. Formalisation therefore legally compels employers to treat employees fairly and provide legal employment benefits and enables enterprise owners to have access to the judicial system in the event of enforcing contractual rights. Formalisation further contributes to the growth of the economy as tax base is broadened as there are more business entities and employed people who contribute to the tax net. Understanding factors that contribute to hindrance of SMEs` formalisation is therefore beneficial to both SMEs and the government.

## **1.7 Scope of the Study**

The study focuses on informal SMEs in Chilenje Market of Lusaka District and is limited to SMEs operating in Chilenje Market. The decision to limit the study to SMEs in Chilenje Market was due to the proximity to the researcher which allowed for an in-depth and critical study to be done whose

findings are useful and important information regarding formulation of strategies and policy frameworks to help informal SMEs transition to the formal economy.

### **1.8 Operational Definitions**

**Formalization** refers to the process whereby previously non-compliant enterprises become integrated into these or state-sanctioned institutions by registering with Zambia Revenue Authority (ZRA), Patents and Company Registration Agency (PACRA), National Pension Scheme Authority (NAPSA) and compliant to Labour Laws.

**Informal SMEs** are SMEs that are not registered with Zambia Revenue Authority (ZRA), Patents and Company Registration Agency (PACRA), National Pension Scheme Authority (NAPSA) and noncompliant to Labour Laws.

### **1.9 Chapter Summary**

In as much as most SMEs find it easier to stay and operate in the informal economy, benefits of operating in the formal economy are enjoyed by SMEs themselves, their customers, and the Government. It is therefore critical to understand factors that hinder informal SMEs from transitioning to the formal economy to better come up with strategies that respond to challenges that informal SMEs face.

## **CHAPTER 2**

### **LITERATURE REVIEW**

#### **2.0 Introduction**

This chapter presents review of relevant literature on enterprise formalization. It also presents empirical evidence based on studies undertaken and reported around the globe and reviews emerging and critical issues while critiquing and bringing out research gaps.

#### **2.1 Defining Enterprise Formalization**

According to Kenyon (2007a: 3) “Formalization refers to the process whereby previously non-compliant enterprises become integrated into these formal or state sanctioned institutions, such as property registries and tax-rolls”. It is argued that formalizing of informal SMEs is key if the tax base must be expanded by collection of revenue locally (Mutakyahwa, 2012). The assumption with this view is that informal SMEs make enough sales or revenue which if formalized would translate to significant contributions through taxation. The assumption is problematic because some SMEs are just survivalists, and the only amount of money government can get from them if they are formalized could just be registration fees paid during formalization process. Some SMEs see formalization to have costlier barriers than benefits anticipated to be gained by operating in the formal economy. It is therefore important that perceptions on the imbalance between costs and benefits are dealt with by developing strategies and policies for formalization to attract many enterprises to transition from informal to formal economy which is in the tax net.

The formalization of SMEs goes hand in hand with the conducive business environment and economic growth provided by the government which in turn leads to increased tax revenues used for provision of public goods and services. It is argued that enterprise formalization brings benefits to businesses operating in the formal economy because competition between informal and formal businesses is reduced (ILO, 2017). It is however difficult to validate the argument by the ILO that informal and formal businesses compete because informal and formal enterprises usually have different market segments. It is however also in the interest of informal enterprises to formalize because formalisation increases their potential for growth, minimizes exposure to government fines and enables them to participate in public biddings and collaborate and partner with larger and established companies.

Formalization requires that enterprises have all the certifications required for their operations and that they are compliant to labour laws by ensuring that employees are registered with government authorities and are entitled to leave days (Williams, 2014). In addition, managerial, accounting competencies and respect for human rights are also key for success of a formalized enterprise (Williams, 2014). This is probably why some enterprises prefer staying informal because it is quite expensive to hire skilled employees or tax consultants to help with remittance of taxes.

Kosh (2019) is of the view that informal SMEs are under the threat of being wiped out of business due to competition from both local and international established formal counterparts and efforts to facilitate their formalization should start with making informal entrepreneurs realize the threats they risk facing. The reason the informal SMEs are under threat of extinction is because they usually do not invest in new technology or upgrading or learning new skills critical for improved provision of goods and services which make formal enterprises have a competitive edge over them. Furthermore, informal SMEs tend to have inadequate skills in marketing, accounting, sales etc, which are key for running successful businesses.

## **2.2 Enterprise Owners` Education Level**

According to the study by (Jiménez et al, 2015) which was undertaken by use of multi-country data by the World Bank Group on enrolment rates in secondary and tertiary education taken from the World Development indicators on formal and informal rates of entrepreneurship, secondary and tertiary education was found to lead to increased formal enterprises due to high self-esteem and perceived lower risks. The study further revealed that people with tertiary education are more aware of repercussions that come with informal enterprises and as a result often tend to prefer formal to informal enterprises. Secondary education in spite of its ability to lead to awareness of repercussions for engaging in informal entrepreneurship, it does not to a large extent deter people from engaging in informal entrepreneurship due to challenges with regard to planning, organizational, administrative or human resource management which force entrepreneurs to remain in the informal sector (Jiménez, 2015).

A study of 11 Pakistan cities revealed contrasting findings that people running informal enterprises were better educated than people working in the formal sector because education was found to lead to higher wages in the informal sector than the formal sector (Williams, 2013). The higher number of better educated people in Pakistan running informal enterprises was due to high taxes

which make tax compliance extremely costly which make business owners remain in the informal economy just like in other countries. Although both Pakistan and Zambia are developing countries, we cannot with certainty conclude that Zambian informal SMEs are also being run by well educated people due to differences in the social and economic environment between the two countries.

A study conducted by Koto (2015) on the determinants of the decision of owners of small enterprises in Ghana to participate in the informal sector at start-up using the 2013 World Bank Enterprise survey data and binary choice models, it revealed that the informal sector in Ghana was dominated by lowly educated people who did not have employable skills. People, therefore, find themselves in informal economic activities as a way of survival rather than attempting to intentionally avoid compliance to formal sector regulations. The findings of this study imply that enterprise formalization also requires some level of education from enterprise owners coupled with policy makers` efforts to provide the right balance between minimizing costs for operating in the informal sector while also reducing formalization costs and increasing the benefits for SMEs participating in the formal economy.

### **2.3 Tax Rates**

A common argument often advanced as the cause for informal enterprises is that higher tax rates lead to higher levels of informality among enterprises. However, results from cross-national comparative studies disprove this notion as in advanced economies, there is no significant relationship between tax rates and enterprise informality levels (Williams, 2014b). In many developing countries, a similar assumption exists that higher tax rates make many entrepreneurs to operate under the informal sector. However, much as this assumption may be true in some cases, it may also mean that in countries where citizens have confidence in the government regarding the usage of taxpayers` money, higher tax rates do not have impact on entrepreneurs` decisions to either operate in informal or formal sector.

Some entrepreneurs find it unfair to incur the costs of compliance with government regulation by paying registration fees, paying taxes, compliant with labour laws and health and safety standards if their competitors are not compliant. Operating in the formal sector is quite costly as requires compliance to the formal economy rules which includes tax remittance, it is therefore important for firms operating in the formal economy to enjoy public services in return for their compliance

and put their businesses at a competitive advantage if formalization is to be seen to be attractive to informal firms.

A study was conducted by the Asian Development Bank (2020) on the rate of taxation compliance by firms after being formalized and to analyze the relationship between formalization and tax payment to ascertain if the government can benefit from formalization through taxation of firms that transition from informal to the formal sector. A panel of dataset built from five small and medium-sized enterprise surveys that were used in Viet Nam between 2005 to 2013 and the study findings indicated that formalization led to increased payment of taxes by twofold much to the benefit of the government. It should be noted that nonregistration of a firm does not imply nonpayment of taxes. Firms in the informal sector still pay taxes although not as much as firms in the formal sector. Formalization should therefore be incentivized for it to attract more firms to opt out of the informal sector because it leads to additional costs in taxes.

Between 2000 and 2004, many formal enterprises in Zimbabwe closed leading to employee layoffs and increased unemployment. The people who lost their jobs resorted to the informal sector which has grown to be a large proportion of the working population (Sikwila et al, 2016). To increase tax base, the Zimbabwean revenue authority introduced a Presumptive Tax Policy. However, it has been difficult to enforce the policy due to non-compliance by poor informal traders. Sikwila et al (2016) carried out a survey of the Bulawayo Metropolitan Province to unravel the practical challenges of enforcement of the Presumptive Tax to a sector that can hardly cope with the basic needs. The results show that size and number of the informal sector, resource constraints, political interference, corruption tendencies, notions of fairness and tax educational gap influence tax collection in Bulawayo, Zimbabwe. Furthermore, findings from the survey indicate that the low incomes generated by the informal sector persuade them to avoid tax.

According to the Lewisian model, the informal sector was thought to automatically formalise with time. However, with time as industrialisation increased, the informal sector was increasing as opposed to diminishing and this suggested the existence of structural barriers to formalisation which needed to be addressed. Sakarombe (2020) conducted a study in Tanzania to identify structural barriers based on theoretical arguments by empirically testing the significance of the causes of the informal sector as they become barriers to formalisation. The structural equation modelling (SEM) approach was used in multiple indicators, multiple causes framework. The study

revealed that barriers to formality included high tax burden, poor institutional quality (poor control of corruption), high government consumption, unemployment rate, and low trade openness. The study recommended reduced tax burden and resort to sovereign wealth fund as a source of income, reduced government size, creation of more jobs, and provision of credit and business development services to informal operators, introduce simplified bureaucratic procedures, and liberalise trade. Due to similarities between Tanzanian and Zambian economies, recommendations by this study are quite applicable in the quest to address informality in the Zambian economy.

## **2.4 Ease of Registration**

The ease of registering business enterprises has been argued as one of the major obstacles to enterprise formalization. Registration of business includes and involves procedures, time, and payment to secure certificates from different government regulatory bodies such as tax, patents, and labour department (Williams, 2014b). The assumption is that easing registration of business enterprises by lowering the costs and reducing time needed by introducing a one-stop service where people can get all the services and register with all the government agencies without the need to visit various places and buildings located in different places will lead to increased formalization of enterprises.

A study by De Mel (2013) in Sri Lanka however, showed that reduced costs and time of business registration or one-stop shop for registration and tax reductions did not result into more business registrations but increased enforcement led to more business registration.

Mexico and Columbia` experiences on the other hand indicate that simplified business registration processes resulted into an increase in formalized businesses by 5% (Andrade et al, 2014). In Peru, business registration simplification resulted into a 43% increase in enterprise registrations notwithstanding that registrations were for one year and most of whom were not renewed the following year (Andrade, 2014). It is interesting to note that most businesses did not renew their licenses the year that followed and we can easily speculate based on other countries` experiences that the high cost of operating in the formal economy is what made the businesses to slide back into the informal economy.

In Malawi, transparency around provision of information to support business firms with registration was successful. According to the field experiment undertaken by Campos (2018) in which firms were provided with assistance for business registration, more than 70% of the

firms had their businesses registered out of which about 10% also registered for tax remittance. It should however be noted that registration of business alone does not lead to profit making and this should be taken into consideration when strategies and policies are developed to facilitate formalisation of enterprises. Enterprise owners need to be given some form of training on how to run businesses which should help them remain formal after registration so that their businesses are profitable enough to enable them to remit tax prevent them from going back to the informal economy on account that being formal is too expensive for them.

Low levels of awareness of business registration regulations are seen to account for an increase in informal enterprises. In Sri Lanka, De Mel (2013) in their study found that only 17% of informal entrepreneurs had the knowledge on business registration process although they believed that the process takes one month which in fact only takes less than one week. A similar study in Bolivia revealed that two-thirds of unregistered enterprise owners did not know where the tax office was located and only 10% of them knew about the commerce registry (Delliot, 2012). It therefore implies that increasing the awareness about procedures regarding business registration is key to increase enterprise formalizations, although there are other factors that should also be taken into consideration when coming up with strategies for formalizing informal enterprises. It is however possible to relate the findings by Delliot to the Zambian context as we think some SMEs owners may not be aware that they can register their businesses with PACRA and Zambia Revenue Authority online without physically going to their offices.

## **2.5 Informal SMEs` Productivity**

One of the challenges that informal enterprises face on average is low productivity compared to their formal counterparts. Informal enterprises tend to have lower margins and often operating in saturated markets which seldom have the absorption capacity of significant compliance costs (ILO, 2021). Low productivity therefore ought to be regarded as a drive for enterprise formalization as it is also a consequence of informality.

From the government and society`s standpoint, untaxed informal enterprises lead to reduced tax base which consequently makes it harder to have provision of public goods and services for the citizens and creation of culture of compliance and social cohesion. From the formal workers and enterprises` point of view, informal economy leads to unfair competition from untaxed informal enterprises and informal workers (ILO, 2021). It is sufficing to state that informality is an obstacle

for enterprises' growth because they can hardly access credit from financial institutions, business development services and business partnerships from other established companies as they require enterprises to meet compliance standards and formal registration such as tax registration and invoicing, decent work, etc.

Informal enterprises are seen as unproductive and inefficient businesses that are a direct competition to formal businesses that do not grow and stay undetected by government authorities which gives them unfair cost advantage over their formal counterparts to compensate for their low productivity and inefficiency (Williams, 2014). Informal firms avoid paying taxes and compliance to other regulations such as labour laws which enable them to undercut prices for their goods and services much to the disadvantage of the formal firms who eventually lose out their market share (Williams, 2014). The unfair competition from informal businesses makes formal institutions fail to have competitive edge over informal businesses which in turn reduces incentives for formal businesses to invest in new technology which limits their competitive advantage over informal counterparts.

Porta and Shleifer (2014), have a different view from Williams and argue that informal and formal businesses are different in entrepreneurial characteristics which are affected by government policies and as such the presence of informal firms should not pose challenges or threats to formal businesses' operations. Informal enterprises are therefore not considered to be competitors for formal enterprises because of association with low productivity and inefficiency attributed to their inability to employ well educated employees. This view undermines the argument advanced by Williams that Informal firms have the capacity to undercut prices for the same products sold in formal markets which may disadvantage formal firms and lead to take away of market share from formal businesses. Porta and Shleifer (2014) therefore suggest that informality only strengthens market segmentation between informal and formal businesses because they serve different groups of consumers due to their different levels of productivity and efficiency. The presence of informal businesses should therefore not pose a threats as formal firms' profitability cannot be affected.

Over 30 years ago, De Soto (1989) argued that burdensome state regulations make firms stay informal and unproductive and that removal of the burdensome regulations would enable firms to have access to finance and lay foundation for their growth which would lead to benefits that would spillover to other already established businesses or new entrants. The problem with this view or

argument is that businesses are run by human beings who always try to avoid spending or paying money where possible. Therefore, if tax enforcement for instance being referred to as burdensome regulation is removed, businesses would not be responsible enough to regulate themselves and provide services that the state provides using taxes collected.

Porta and Schleifer (2014) have a different view from De Soto's and argue that the difference between informal and formal businesses lies in the education, skills, experience and attitudes possessed by people managing the businesses which lead to differences in the performance of firms. They further argue that enterprise development should be the key focus area for policy makers because the levels of informality eventually go down as the countries develop (Porta and Schleifer, 2014). The evidence of informality in developed countries poses a challenge for this view. Additionally, there are well educated, skillful and experienced people who would in some instances intentionally decide to operate in the informal sector for them to avoid paying taxes.

Ulysea (2018) did an analysis of data from Brazilian firms and made an estimated finding that is similar to De Soto's view that 9.3% of informal enterprises could be viewed as having the potential and capacity to perform productively and operate in the formal economy if costs for operating in the formal economy were brought down. Ulysea further estimated that 48.8% informal firms would not survive if left to operate in the formal economy while 41.9% of informal firms have the capacity to absorb costs of formalisation and costs of operating in the formal economy but nonetheless opt to staying informal (Ulysea, 2018). From both scenarios, we see that the cost of formalization and operating in the formal sector is serious factor which demands serious attention when devising strategies and policies to facilitate formalization of informal SMEs if formalization quest is to be successful.

## **2.6 Challenges of Formalisation**

Formalization of informal enterprises ought to take various forms such as coming up with incentives to motivate informal firms to get registered and for benefits to accrue upon registration as well as spilling over of formal benefits to employees. However, formalisation has several challenges which are discussed below.

One of the challenges with formalisation is that it is not a one-time process but a gradual process which involves several steps to be fully implemented. Informal firms that choose to register their businesses must follow various bureaucratic procedures and benefits of operating in the formal

economy do not come immediately while they are expected to pay taxes and other fees for operating in the formal sector (Mugisa, 2021). Employees in the informal enterprises also do not see benefits immediately because their labour standards and benefits need to have negotiated between the government and the employers including workers and employers` representatives (Mugisa, 2021). It should be noted therefore that the goal for formalisation is not to attempt to formalise all informal firms as this is untenable ambition because several firms will remain informal for quite a foreseeable future as even the most developed of nations still have some levels of informality in their economies. The aim of formalisation therefore is to have a good number of informal firms graduate to formal firms in quest to broaden the tax base and create more formal employment opportunities and increase the benefits for operating in the formal economy.

The other challenge that comes with formalisation is the absence of visible immediate benefits in formal enterprises and this makes some businesses backtrack to the informal economy as they better services, protection, access to credit, trainings and make more money among many other benefits immediately after formalisation. It is therefore important for the authorities to provide full information about formalisation to avert such unrealistic expectations from informal business owners.

According to Benjamin (2014), formalisation is attractive if its benefits far outweigh the costs and it may not be attractive on the other hand if it does not lead to visible benefits even if the costs are minimal because firms would prefer staying informal. Benefits are critical if formalisation is to be attractive as lack of them leaves enterprises with no choice but to remain informal especially in the event where the informal market is bigger than the formal one and public services provided by the government do not satisfy people and formal firms can barely have access to credit, protection or business trainings etc. in such circumstances, not even the lowest of costs associated with formalisation would make informal firms transition to the formal economy. This is probably one of the factors that are behind high numbers of informal SMEs in Zambia as there are too many reports of poor services such as toilets without water which are supposed to be provided by local government authorities who always collect levies yet do not provide satisfactory services. Consequently, reforms that seek to promote formalization should find the right balance between reducing costs and maximize benefits in equal measure.

Sophia (2019) conducted a study in Zimbabwe to analyse the impact of growth constraints on the willingness to formalise by informal micro and small-scale enterprises. Twenty internal and external growth inhibiting factors were analyzed using Principal Component Analysis (PCA) and a logistic model was estimated on a dichotomous variable of willing/not willing to formalize. The results revealed that that willingness or unwillingness for informal entrepreneurs in Zimbabwe to formalise is significantly linked to institutional imperfections and asymmetry of bureaucracy associated with the registration process, lack of access to technology, market and financial constraints and lack of entrepreneurial and management skills. Sophia (2019) suggests that improving the bureaucracy of the registration process and access to technology may possibly increase the odds of the informal operators formalising their businesses. Campos et al (2018) in their study in Malawi showed us that improvement in bureaucracy and registration led to more registration of businesses but did not lead to higher tax remittance. However, improvement in market and financial constraints and entrepreneurial and managerial skills will decrease the odds of willingness to formalise.

A major obstacle to formalization relates to uniform reforms that are not aimed or tailored to meet specific needs for different targets in the informal economy (ILO, 2016). Informal sector has variations which warrant it to be treated like that, hence policy makers should be aware that strategies and policies employed in the urban areas to promote formalisation may not work in rural areas for example. Equally, what works for instance for SMEs in the agriculture sector may not work in the tourism sector. Consequently, formalization strategies should be tailored to the contextual realities of respective informal sector while productivity is increased and working conditions are improved, and regulations and restrictions when necessary are kept at a minimum.

## **2.7 Benefits of Formalisation**

Growth of business ventures is critical for the ultimate growth of the economy because of the potential they must create employment and subsequently lead to improved living standards of the people. However, business ventures can only grow when they are formalized and are operating as formal business entities, and this is the challenge that SMEs have in Zambia as most of them are operating in the informal economy. This is further reflected by the number (73%) of working population employed in the informal economy according to the (CSO, 2018).

Formalization is regarded to have many potential benefits for the economy such as poverty reduction, creation of bigger and stronger economies with improved goods and services. Formalisation of informal businesses is important for governments as it is a strategy for economic development and poverty reduction (Benjamin, 2014). Having more formal businesses entails having more productive and efficient firms that contribute to the tax base and have the capacity to grow and expand their operations as they can access finance. Formalisation is critical for the government as it broadens the tax base which funds provision of public services.

Formalisation is also benefits business owners far much beyond mere acquiring of licenses to operate in the formal sector but enables them to potentially have commercial contracts, membership in trade associations, legal ownership of their places of business and increase their productivity, enjoy tax breaks and incentive packages to increase their competitiveness, protection against creditors and clear bankruptcy rules, and social protection (Mugisa, 2021). Workers in the informal economy benefit from formalisation through securing formal contracts, leave days, ability to join formal trade unions and contributions to their social security through the employers.

Using data from surveys of microenterprises in South Africa, Namibia, Botswana, Kenya, Uganda, Tanzania, and Rwanda, Gelb et al (2009) found that the labor productivity of informal firms is virtually indistinguishable from that of formal firms in East Africa, but very different in Southern Africa. They provided a theoretical model to explain this result, based on the key assumption that firms may evade taxes subject to a cost (or concealment cost) that is increasing and convex in the firm's employment size. Consequently, the productivity distributions reflect the differences in concealment costs and the opportunity cost of formality. Greater enforcement of laws and better provision of services such as finance and electricity to formally registered firms in Southern Africa means that firms are more likely to register; those that do not are likely to be operating as "survivalist" firms while in East Africa, weak enforcement of tax payment and no significant difference in access to services between formal and informal firms means that these variables do not explain the allocation of firms across the informal-formal divide (Gelb et al, 2009).

Gelb et al (2009) concluded that in countries with weak business environments, informal firms are just as likely as formal firms to increase their productivity as they grow. Thus, interventions to increase productivity and lower the cost of formality may be helpful. However, in countries with

strong business environments such as those in Southern Africa, owners of informal firms are likely to be better off entering the labor market as wage labor. In the latter case, investment in education or vocational training is probably more important.

## **2.8 Strategies for Enterprises` Formalization**

According to the ILO (2014a) there is a distinction between formalizing enterprises and formalizing employment and this distinction should be considered when devising strategies for formalization to ensure that policy makers are aware that policies designed to facilitate enterprise registration do not always lead to formal employment and compliance with labour laws.

Because informal enterprises are typically considered to be unregistered and unlicensed, logic suggests that reforms that make registration and licensing easier and cheaper would have a direct effect on the process of formalization. Indeed, the ILO (2014a) argues that these reforms should be an important cornerstone of any agenda to formalize businesses. The most common strategies for doing this include reducing or consolidating the number of steps required to register, simplifying administrative processes for licensing, reducing, or eliminating minimum capital requirements, administrative deadlines, and positive administrative silence, and digitizing the process and using on-line facilities. Initiatives in this field have also included the creation of one-stop-shops and establishing simplified legal formats for micro businesses. As important as these reforms are, it should be recognized they may not be enough. Several reviews and evaluations in recent years have found that improving business licensing and registration does not, on its own, appear to work as a strategy for formalization, at least in terms of the number of businesses registered and licensed. Thus, other reforms are needed to complement and bolster these efforts.

The other strategy for enterprise formalization is by getting rid of inappropriate taxation systems which have been found to encourage informality. Many enterprises fail to comply with the tax system because it is too complex, expensive, and opaque. In many cases, enterprises are simply not aware of their tax obligations or fearful of the tax system. A desire to avoid tax is often at the heart of the decision to not register or obtain the necessary licenses. Tax compliance can be eased by introducing more transparent and simplified tax reporting requirements, improving tax inspections, reducing the number of payments, offering different payment options, and differentiating tax schemes for SMEs (ILO, 2017). Tax policy reform typically involves reducing the complexity of procedures and the multiplicity of taxes, while addressing the lack of information

about tax obligations (ILO, 2017). Reform strategies include the introduction of special tax regimes for SMEs, the simplification of accounting standards, reporting requirements and payment facilities within the general tax regime, providing better information and technical assistance to enterprises, and improving inspection to reduce tax evasion.

According to the OECD (2020), information sharing about the benefits that come with enterprise formalisation and consequences of operating in the informal economy is also a good strategy that helps with enterprise formalisation. Governments in their quest to promote business registration should provide full information regarding anticipated benefits such as being able to have access to finance which is key for business growth and participation in public tender biddings as well as partnering and collaborating with established big companies.

The other strategy is to create incentives to help SMEs formalise which can be done by developing dedicated and targeted schemes of financing and capacity building programmes for SMEs especially to have more businesses registered and ultimately lead to higher GDP and growth rates (OECD, 2020). Policy makers should, however, be careful with provision of incentives such as tax breaks with their promotion of formalisation because incentives may be costly, and benefits of registering businesses may take time to be realized.

Formalisation strategy should aim to ensure that enterprise registrations also translate into formal jobs, and this is done through registering domestic workers on social insurance coverage, recognition of prior learning and decentralization of service provision to local level (Leung and Kiaga, 2020). In Cameroon and Tanzania, enterprise formalization includes reforms to improve the business environment, appropriate regulatory framework, and access to credits (Leung and Kiaga, 2020). The Cameroonian government further implements specified programmes to support transitioning of informal firms to the formal economy which is linked to employment formalisation.

Enforcement of regulations that require informal enterprises is an alternative strategy for formalisation. However most of the governments around the world are reluctant to use this approach because most of informal SMEs genuinely do not have the capacity to operate in the formal sector due to their low productivity and inefficiency coupled with their inadequate skills that are key to remain competitive in the formal economy (OECD, 2020). Enforcement of the laws and regulations to enhance compliance should only be done in combination with creation of the

environment that facilitates business registration and incentives that promote and benefit formalisation and inhibit informality. Enforcement of formalisation compliance measures should not discourage entrepreneurial activities but should rather encourage the culture of entrepreneurship.

## **2.9 Theoretical Framework**

Institutional theory provides a useful understanding in relation to factors that hinder formalization of informal SMEs. Institutional theory is based on understanding of social structure and how norms, routine tasks and schema get established as authoritative regulators of social behaviour (Scott, 2004b).

According to institutional theory, societies are governed by regulations and laws called formal institutions. However, societies also have informal institutions which have socially unwritten accepted norms, values, beliefs, and regulations communicated and enforced through unofficial channels (Williams & Shahid, 2014). Williams and Shahid further argue that when laid down formal institutions` laws and regulations are different from beliefs, norms and values of informal institutions, there emerges economic activities that are not in line with formal institutions but are deemed acceptable by informal institutions (Williams & Shahid, 2014).

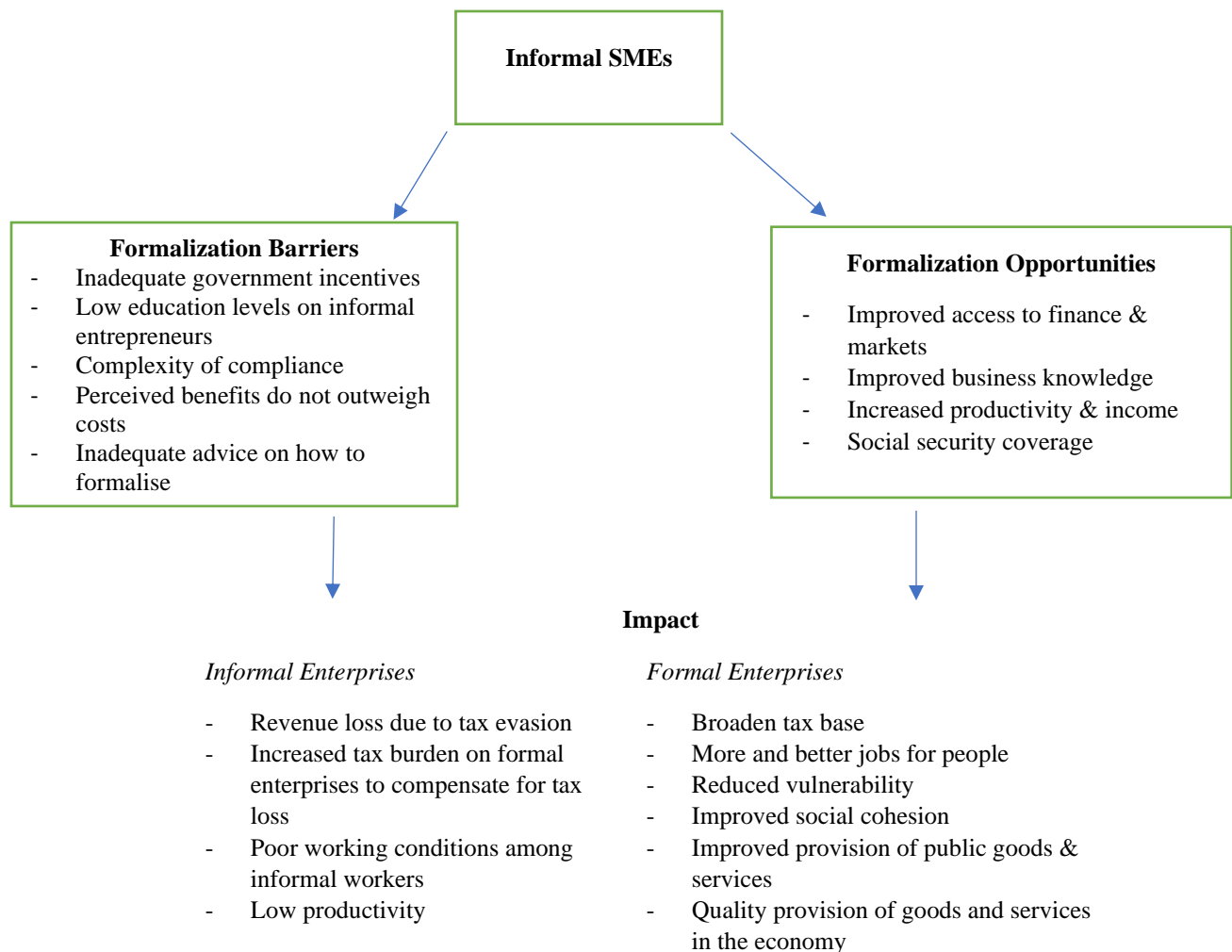
SMEs operating in the informal sector do so outside regulated formal institutions yet within the confines of informal. These SMEs are regarded as illegal from the standpoint of formal institutions yet seen as legitimate business entities from informal institutions perspectives of belief system and values (Williams & Vorley, 2014). Informal SMEs are therefore determined by the difference between informal and formal institutions. A bigger difference is highly likely to lead to high informality and similarity between the two is also likely to lead to higher informality (Williams & Vorley, 2014). This is probably because there is less motivation for formalizing business enterprises if both informal and formal enterprises are similar.

The institutional theory is appropriate for the study of factors hindering SMEs` formalization because it is premised on processes that lead to regulatory framework which ultimately results into legitimacy and formality.

### **2.9.1 Conceptual Framework**

The proposed conceptual framework for this study is in figure 2.1 below and was developed based on available literature on benefits and barriers to SMEs` formalization as well as the impacts that

both have on the economy. A conceptual framework is regarded as a structure that researchers use to explain and show the flow of their studies (Camp, 2001).



**Figure 2.1:** Conceptual framework

One of the barriers to enterprise formalization is inadequate information on the benefits enterprise formalization and consequences of being informal. The Government should therefore promote enterprise formalization by explaining benefits that come with business registration such as improved access to financial services, markets, business support services and social coverage (OECD, 2020).

Inadequate incentives to help businesses formalize is another challenge about formalization. Deliberate schemes of financing and training programmes for business enterprises have the

capacity to lead to higher registrations of businesses which can translate into more revenue and economic growth (OECD, 2020). However, caution should be exercised when giving out incentives and tax breaks as these incentives could be costly because it takes time for the government to benefit from formalization of businesses.

The level of education among informal entrepreneurs determines the likelihood of formalization. In this regard, entrepreneurs with post-secondary school education training are more likely to formalize their businesses than those without post-secondary school education (Shah, 2012). This is because entrepreneurs with higher level of education better understand the limitations and business challenges that come with informality and benefits of running formalized businesses.

Globally, majority of the workers in the informal enterprises face serious decent work deficits such as social security coverage and protection and basic income which make them vulnerable because they cannot access health care and decent housing. The vulnerability of informal workers causes a vicious circle of poverty for the individuals involved and their families and also creates an economic and social development crisis for the country (ILO, 2018a). The absence of social protection among informal businesses' employees' is due to their inability to make social insurance regular contributions.

Informal enterprises do not pay taxes and the tax shortfall created is unfairly placed on shoulders of formal enterprises. Further, the tax shortfall created by informal businesses leads to limited fiscal space by the government and limits government expenditure on infrastructure and social services such as health and education.

## **2.9 Chapter Summary and Research Gaps**

In this chapter, the literature on the relationship between formalisation and enterprise owners' education Level; tax rates; ease of registration; cost of informal enterprises; and informal SMEs' productivity has been reviewed. Literature on challenges of formalisation; benefits of formalisation; and strategies for enterprises' formalization has also been reviewed. While reviewed literature showed that formalisation of enterprises by way of registering businesses did not automatically lead to benefits such as more profits, access to credit, and growth, in other parts of the world, Chilenje Market is different from other places mentioned in the literature. Chilenje Market is unique and has grown both in terms of the population and business activities taking place as many SME owners have come on board which warrant an investigation of factors which

contribute to hindrance of SMEs` formalization in Chilenje Market of Lusaka District. The study will contribute to measures that will lead to growth of SMEs in Chilenje Market in Lusaka District.

## **CHAPTER 3**

### **METHODOLOGY**

#### **3.0 Introduction**

This chapter describes the research methodology which Kothari (2004:8) defined as “a way to systematically solve the research problem. It may be understood as a science of studying how research is done scientifically. In it we study the various steps that are generally adopted by a researcher in studying his research problem along with the logic behind them”. The following research steps were used in this study; research philosophy, research design, sampling size and techniques, sample size, data collection instruments, validity of the data collection instruments, data analysis, data collection procedure and reliability and validity.

#### **3.1 Research Philosophy**

Bajpai (2011) opines that research philosophy is about management of the knowledge from its source which is influenced by the researcher`s belief with regard to how data is collected and analysed as well as interpreted or used. Generally researchers use Pragmatism, Positivism, Realism, and Interpretivism as research philosophies. This study adopted the use of pragmatism research philosophy due to its ability (Saunders et al, 2012) to combine strengths for both positivism and interpretivism research philosophies. Saunders et al (2012) say that pragmatics “recognise that there are many different ways of interpreting the world and undertaking research, that no single point of view can ever give the entire picture and that there may be multiple realities”.

The use of qualitative and quantitative approach justifies the choice of pragmatism research philosophy which combines interpretive and positivism philosophical assumptions in social sciences. According to Denscombe (2010) positivism and interpretivism philosophies have historically been oriented in social research since inception and been categorized into either empiricist or humanist research. Below table 1 shows pragmatism research philosophy integrated with positivism and interpretivism.

**Table 3.1:** Pragmatism research philosophy Integrating Positivism and Interpretivism

<b>Research Philosophy</b>	<b>Research Approach</b>	<b>Ontology</b>	<b>Axiology</b>	<b>Research Strategy</b>
Pragmatism	Deductive/Inductive	Objective or subjective	Value-free/biased	Qualitative and/or quantitative
Positivism	Deductive	Value-free	Quantitative	quantitative
Interpretivism	Inductive	Subjective	Biased	Qualitative

Source: Wilson, J. (2010) “Essentials of Business Research”

The study adopted pragmatism research philosophy because it combined both quantitative and qualitative research methods. Under pragmatism research philosophy, there is application of more than one research approach and strategy within the same study by the researcher.

### **3.2 Research Design**

A research design is a type of inquiry through which research study procedures are provided for be they under quantitative, qualitative, or mixed methods approaches (John W, 2018). This study has adopted a parallel convergent mixed methods design for easy merging of quantitative and qualitative data on factors that hinder SMEs` formalization in Chilenje Market of Lusaka District.

Creswell (2019) describes parallel convergent mixed methods as a design in which the researcher both quantitative and qualitative data to have a comprehensive analysis of the issue or phenomenon under study. The researcher under this design collects both qualitative and quantitative data at the same time and integrates it in the interpretation of results while explaining differences in the findings. The choice for using parallel convergent mixed methods design was because the study required a bigger sample to get a better understanding of the factors that hinder informal SMEs from transitioning to the formal sector. The easier way to collect and analyze data from a bigger sample is through use of parallel convergent mixed methods design.

### **3.3 Study Area**

The study was carried out from Chilenje Market of Lusaka District Area. Chilenje Market was chosen because of the increasing number of SMEs` activities taking place. Further, Chilenje

Market was chosen due to its proximity to the researcher to reduce on costs associated with movements for data collection because the study was self-funded.

### **3.4 Target Population**

Kumar (2011) defines target population as a group of individuals from which the sample population is selected. According to Cooper (2014) a target population refers to a total collection of elements that have common patterns or characteristics from which the researcher makes inferences. In this study, the population of interest were SMEs owners in Chilenje Market of Lusaka District and key informant conversant with the Zambia Development Agency (ZDA), PACRA, ZRA, Ministry of Small and Medium Enterprises, ILO, Citizens Economic Empowerment Commission (CEEC) and Ministry of Labour and Social Security.

### **3.5 Sample Size**

According to Smith (2013), a sample refers to a group of people, things or items which are taken for measurement from a larger population. Using Taro Yamane's formula, the total sample was calculated as follows:

$$n = \text{population total} / 1 + \text{total population} (0.05)^2$$

$$n = 595 / 1 + 595 (0.05)^2$$

$$n = 595 / 1 + 1.4875$$

$$n = 595 / 2.4875$$

$$n = 239.19 = \mathbf{239}$$

A total of 239 questionnaires were distributed to SMEs in Chilenje Market out of 187 questionnaires representing 78% were received for analysis. This study's sample therefore had a total of 194 respondents from which 187 were informal SME owners of from Chilenje Market of Lusaka District and 7 key informants.

### **3.6 Sampling Techniques**

Sampling techniques are methods which are used to select people or items that should take part in the study, and they include probability and nonprobability techniques (Sekaran & Bougie, 2015). Probability sampling techniques offer the study sample equal chances to be picked and include stratified sampling, simple random sampling, cluster sampling, systematic sampling, and multistage sampling. Nonprobability sampling techniques on the other hand has an open bias and does not offer study sample equal chances to be selected and comprises of convenience sampling, judgmental or purposive sampling, quota sampling and snowball sampling.

Random sampling was used to collect quantitative data to give all informal SMEs equal chance to participate in the study. The reason for using the random sampling was due to availability of the sampling frame for all informal SMEs operating from Chilenje Market.

Purposive sampling was adopted and deemed appropriate for collection of qualitative data to ensure that specific respondents of greater interest for the study were not left out. Cooper (2014) validates the use of purposive sampling as a method that targets a suitable group that is critical to the right and rich informal needed for the phenomenon under an in-depth analysis.

### **3.7 Data Collection Instruments**

The use of Mixed Methods Approach necessitated collection of data via both the questionnaire and the structured interview schedule both of whom were designed specifically for this study. The choice for use of the structured interview schedule and questionnaire is given below:

#### **3.7.1 Questionnaire**

The quantitative part of the data was collected with a questionnaire which is an appropriate tool for quantitative data collection. A questionnaire is defined as a list of printed questions which should be completed by respondents to get their opinions by (Roopa, 2012). Additionally, a questionnaire was chosen to be a tool for collection of primary data in a standardized way to ensure there was consistency and coherency in data analysis.

The questionnaire used was closed which had closed ended questions that were much easier to analyze using the computer. In addition, the closed questionnaire enabled the researcher to collect data within a short period of time as respondents were able to quickly respond to questions.

#### **3.7.2 Questionnaire Design**

The questionnaire was designed to show the number of formalised enterprises in Chilenje Market, level of education for enterprise owners, enterprise owners` views about the benefits of operating in the formal economy, and reasons of operating in the informal economy.

#### **3.7.3 Interviews with Key Informants**

Qualitative data from key informants was collected using structured interview schedule and this was done to validate data that was collected via questionnaires from informal SME owners. Babbie (2007:186) opines that a research informant is “a person who is well versed in the social

phenomenon that you wish to study and who is willing to tell you what he or she knows about it". The study targeted 7 institutions namely Zambia Development Agency (ZDA), PACRA, ZRA, Ministry of Small and Medium Enterprises, ILO, Citizens Economic Empowerment Commission (CEEC) and Ministry of Labour and Social Security.

### **3.8 Data Collection Procedure**

The questionnaires were printed and administered to research participants who wrote their responses on them. Questions were read out to illiterate research participants and their responses were recorded by the researcher on the questionnaires. Questionnaires were written in English and were translated by the researcher to either Nyanja or Bemba for participants who did not understand English. Nyanja and Bemba were selected because they are the predominantly spoken local languages in Lusaka Province which hosts Chilenje Market from which research respondents operate.

Secondary data was collected by reviewing peer reviewed journals, published and nonpublished books, research papers, conferences etc.

### **3.9 Data Analysis**

Collected quantitative data was checked, cleaned, and coded after which it was analyzed using Statistical Package for Social Sciences (SPSS) to come up with descriptive statistics some of which will be entered into Micro Soft Excel to come up with graphical, figures and table representation of the findings. Qualitative data collected from key informants via structured interviews was analyzed qualitatively using themes and contents in which similar items or themes are grouped together from many voluminous words.

### **3.10 Reliability and Validity**

Stoep *et al* (2009) defines reliability as the extent to which a study or measure produces similar results when it is repeated under similar circumstances on the same group of people while validity measures the claims made in a test or study if it is truthful or not.

The researcher therefore considered reliability in this study by ensuring that questionnaires and interviews were done within a short period of time without inconveniencing respondents thereby negatively comprising their responses. The researcher also attempted to make questions in both the questionnaire and structured interview schedule clear and free of ambiguity and interviews and questionnaire administration were conducted according to the convenience of respondents. The

questionnaire was pretested before being administered to research respondents and this allowed for its further refinement and correction.

The researcher took care of validation by collecting data on his own and ensuring that the whole the process of data collection with both the questionnaire and interview and analysis was done correctly.

### **3.11 Credibility and Trustworthiness**

According to (Creswell, 2014) studies that are premised on qualitative approach usually use non-random samples and instruments which are not standardised. Creswell (2014) proposes four strategies (credibility, transferability, trustworthiness, and conformability) through which reliability of qualitative studies can be achieved. This study ensured credibility and trustworthiness as explained in the following paragraphs below.

The researcher selected the most suitable data collection method for the target respondents, the tool for analysis, sampling method, determined best informants for the study, and assessed his skills to achieve credibility and trustworthiness.

During data analysis, the researcher determined how categories and concepts were created, overlaps between categories were checked, the degree of interpretation to ensure that data accurately represent information provided by respondents and representatives of the data were determined.

Finally, the researcher ensured that findings for the study were reported systematically and logically to ensure that there were connections between the data and results reported. The content and structure of concepts were also presented in a clear and understandable way that readers were able to evaluate the transferability of the findings.

### **3.12 Ethical Considerations**

Ethics are the norms or standards for conduct that differentiate right from wrong and are very critical in research as they help researcher to draw the line between acceptable and unacceptable behaviours (Sarantakos, 2015). One of the ethical issues in research is informed consent which refers to voluntary consent by research respondents to take part in the study after being informed of the objective of the research. The researcher sought consent from all study participants before administration of the questionnaires through consent forms which participants signed. Participants

were free to remain silent if they did not want to respond to any question, their names were not used, instead they were assigned identity numbers and were free to withdraw from the study if they so wished to. In addition, participants` responses were treated with confidentiality and were and will only be used for academic purpose. The researcher also sought ethical approval from the University of Zambia Ethics Committee before data was collected.

### **3.13 Chapter Summary**

The chapter was organized into subtitles namely, research philosophy, research design, sample size, sampling techniques, data collection instruments, validity of the data collection instruments, data collection procedure, data analysis, and reliability and validity.

# CHAPTER 4

## QUANTITATIVE DATA PRESENTATION

### 4.0 Introduction

This chapter presents the findings of the study in form of tables, pie charts and graphs. The main aim of the study was to investigate factors which hinder SMEs` formalization in Chilenje Market of Lusaka District and was guided by the following objectives: To identify factors that promote SMEs to operate in the informal economy; to analyze the competitive advantage that formal SMEs have over informal SMEs; and to find out if the legal environment supports informal SMEs` transition to the formal economy.

The chapter is divided into four sections namely demographic characteristics of respondents; SMEs operating in the informal economy; formal SMEs` competitive advantage over informal SMEs; and Government`s support of informal SMEs` transition to the formal economy. Research findings are presented under the four sections in relation to the three research objectives.

### 4.1 Demography Characteristics of Respondents

The demographic characteristics of respondents comprised of their gender, age and education levels which may have a bearing or an effect on respondents` decision to either formalise their enterprises or not.

#### 4.1.1 Gender

The respondents were asked to state their gender and the following were results on figure 4.1.

**Figure 4.1:** Gender distribution of respondents

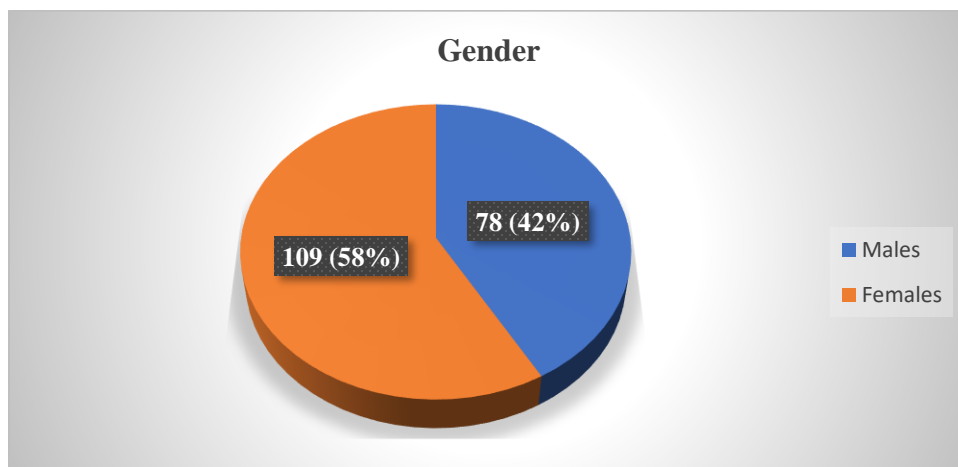


Figure 4.1 shows the gender of respondents in the study. From the total of 187 respondents, 42% were males representing 78 and 109 were females representing 58%. Majority of the respondents were females as seen in the figure above.

#### 4.1.2 Age

Respondents were asked to state their ages. Results in the table below show respondents' age distribution.

**Table 4.1:** Respondents' age distribution

<b>Age Groups</b>	<b>Frequency</b>	<b>Percent</b>	<b>Cumulative Percent</b>
15 - 19 years	7	3.7	3.7
20-29 years	56	29.9	33.7
30-39 years	50	26.7	60.4
40-49 years	48	25.7	86.1
50-59 years	20	10.7	96.8
60-69 years	5	2.7	99.5
80-89 years	1	.5	100.0
<b>Total</b>	<b>187</b>	<b>100.0</b>	

Table 4.1 indicates respondents' age group distribution from which 7 were in the 15 – 19 age group which represented 3.7%; 56 were in the age group of 20 – 29 and represented 29.9%; 50 were in 30- 39 age group thereby representing 26.7%; 48 were found in age group of 40 – 49 representing 25.7%; 20 were in the age group of 50 – 59 representing 10.7%; 5 were in the age group of 60 – 69 representing 2.7%; and 1 was in the age group of 80 – 89 representing 0.5%. Most of the respondents fell in the age group between 20-29 followed by 30-39 and 40-49. The number of respondents significantly reduced after the age group of 50-59 indicating that most people do not engage in business activities in their old age. 3.7% of respondents in 15-19 age group shows that most of the young people in this age group are usually still in secondary schools hence a small number of those who complete their secondary school studies engage in business.

#### 4.1.3 Educational Level of Respondents

The respondents were asked to indicate their level of education which was measured according to the Zambian Education System as indicated in the table below:

**Table 4.2:** Respondents` levels of education

<b>Level of education</b>	<b>Frequency</b>	<b>Percent</b>	<b>Cumulative Percent</b>
Bachelors	8	4.3	4.3
Diploma	33	17.6	21.9
College Certificate	16	8.6	30.5
Grade 12	108	57.8	88.2
Grade 9	20	10.7	98.9
Grade 7	2	1.1	100.0
<b>Total</b>	<b>187</b>	<b>100.0</b>	

Table 4.2 shows that 8 respondents had a bachelor`s degree level of education which represented 4.3%; 33 respondents had diplomas representing 17.6%; 16 had college certificates representing 8.6%; 108 had grade twelve (12) certificates representing 57.8%; 20 had grade nine (9) level of education representing 10.7%; and 2 respondents had grade seven (7) level of education representing 1.1%. Majority of respondents had grade twelve (12) certificates followed by diplomas, and grade nine (9).

## **4.2 SMEs Operating in the Informal Economy**

Respondents were asked to state the types of their businesses and whether their enterprises were registered with PACRA and ZRA as well as among other things to indicate whether they thought it was beneficial to have their businesses registered. This was done to ascertain the nature of SMEs operating in the informal economy by use of certain proxy indicators which helped to reach at certain conclusions.

### **4.2.1 Type of Business for Respondents**

Respondents were asked to state their type of business and table 4 below shows the results:

**Table 4.3:** Business types

Type of Business	Frequency	Percent	Cumulative Percent
Hair dressing (salons & barbershops)	27	14.4	14.4
Clothing	52	27.8	42.2
Auto shops	21	11.2	53.5
Food	28	15.0	68.4
Hardware	25	13.4	81.8
Groceries	28	15.0	96.8
Liquor shop	5	2.7	99.5
General dealers	1	.5	100.0
Total	187	100.0	

Table 4.3 reveals that 27 respondents were involved in hair dressing businesses representing 14.4%; 52 were involved in clothing businesses representing 27.8%; 21 were involved in auto shops representing 11.2%; 28 were running food businesses representing 15.0%; 25 were involved in hardware type of business which represented 13.4%; 28 were involved in groceries representing 15.0%; 5 were running liquor shops which represented 2.7%; and 1 was running a general dealers type of business and represented 0.5%.

#### 4.2.2 Registration of SMEs with PACRA and ZRA

Respondents were asked to state whether their enterprises were registered with PACRA and ZRA and the following results are shown below in figure 4.2:

**Figure 4.2:** Registration of SMEs

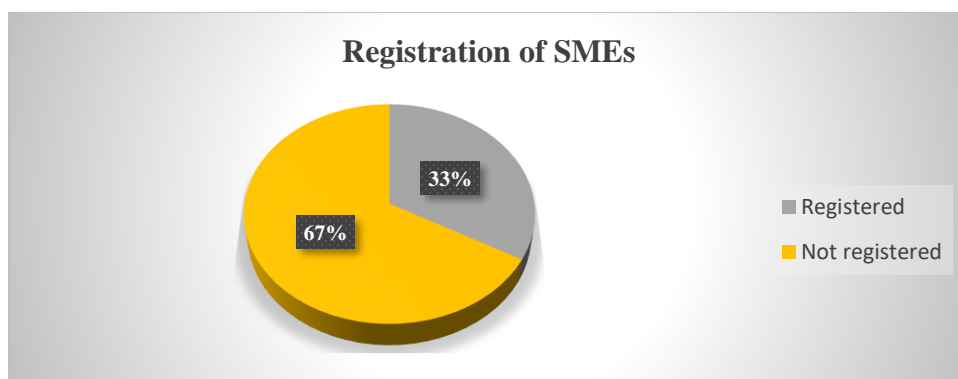


Figure 3 reveals 62 enterprises were registered with PACRA and ZRA representing 33% while 125 enterprises were not registered with PACRA and ZRA representing 67%.

#### 4.2.3 Why SMEs are not Registered with PACRA and ZRA

Respondents whose enterprises were not registered with PACRA and ZRA were asked to state reasons for not registering their businesses. The results were revealed as indicated in figure 4.3 below:

**Figure 4.3:** Reasons for nonregistration of SMEs with PACRA and ZRA

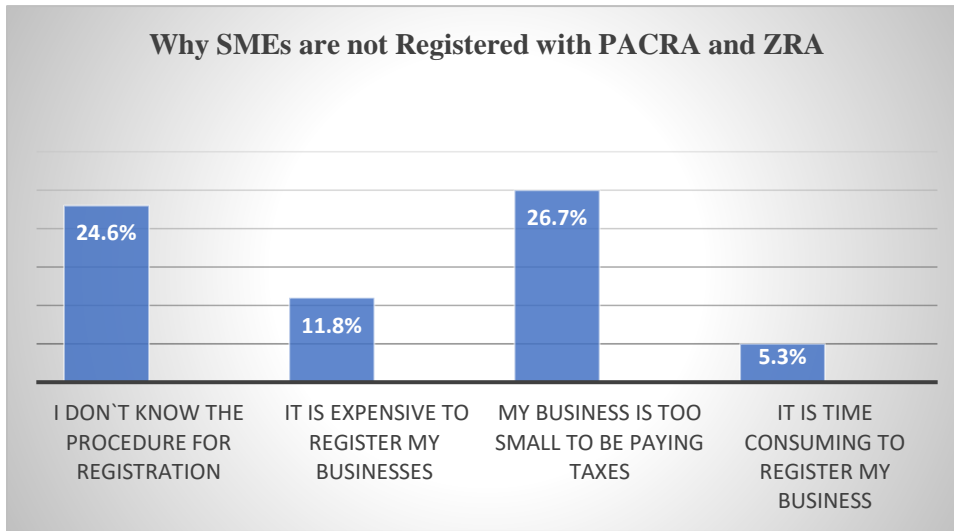


Figure 4.3 indicates that 46 respondents representing 24.6% from the total of 125 respondents whose enterprises were not registered with PACRA and ZRA indicated that they did not know the procedure for registration; 22 said it was expensive to register their businesses representing 11.8%; 50 indicated that their businesses were too small to be paying taxes representing 26.7%; and 10 indicated that it was time consuming to register their businesses representing 5.3%. All the reasons provided by all respondents for not registering their businesses suggested that respondents did not have information regarding what is involved in business registration with ZRA and PACRA.

#### 4.2.4 Duration of Respondents' Businesses

Respondents were asked how long they were in their businesses. Below are the results in table 4.4:

**Table 4.4:** Respondents` time in business

<b>Period in Business</b>	<b>Frequency</b>	<b>Percent</b>
Less than 1 year	43	23.0
1-5 years	93	49.7
6-10 years	34	18.2
11-15 years	14	7.5
16-20 years	3	1.6
<b>Total</b>	<b>187</b>	<b>100.0</b>

Table 4.4 shows that 43 respondents had been running their business for less than 1 year, representing 23.0%; 93 respondents had been doing their businesses for 1-5 years and this represented 49.7%; 34 were in business for 6-10 years and this represented 18.2%; 14 had been running their businesses for 11-15 years, representing 7.5%; and 3 had been running their businesses for 16-20 years, representing 1.6%. Most of the businesses were 1-5 years old followed by less than 1-year-old businesses and 6-10-year-old businesses. The oldest businesses ranging from 16-20 years were the minority (1.6%) followed by 11-15-year-old businesses at 7.5%. Results suggest that most SMEs do not exceed 20 years of operation.

#### **4.2.5 Full Time Employees in Respondents` Businesses**

Respondents were asked to state the number of workers that were employed in their businesses and the following results were revealed as indicated in figure 4.4:

**Figure 4.4:** Number of workers in businesses

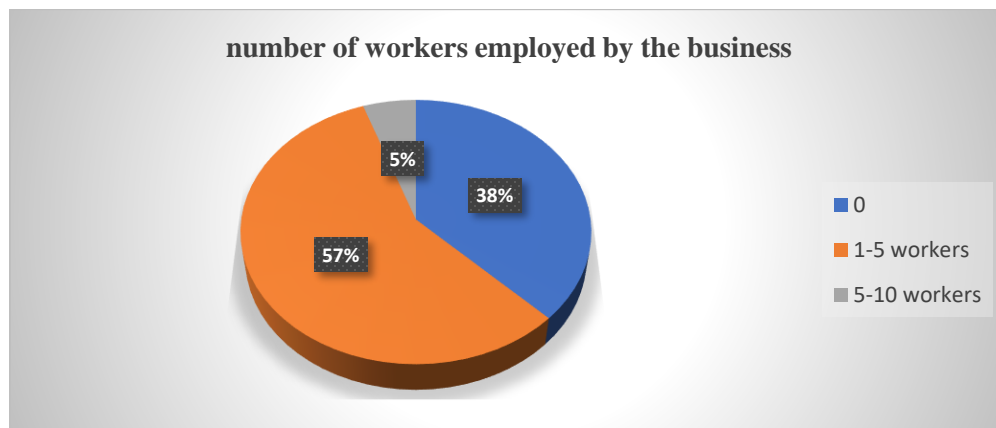


Figure 4.4 shows that 70 respondents representing 38% did not have workers in their businesses; 107 respondents representing 57% had between 1-5 workers in their businesses; and 10 had 5-10 workers in their businesses representing 5%. Majority of the business enterprises (57%) had 1-5 workers followed by 38% of respondents that did not have workers.

**4.2.6 Records in Respondents` Businesses**

Respondents were asked to state whether they keep records for their businesses or not and below are the results as shown in figure 4.5:

**Figure 4.5:** Business records

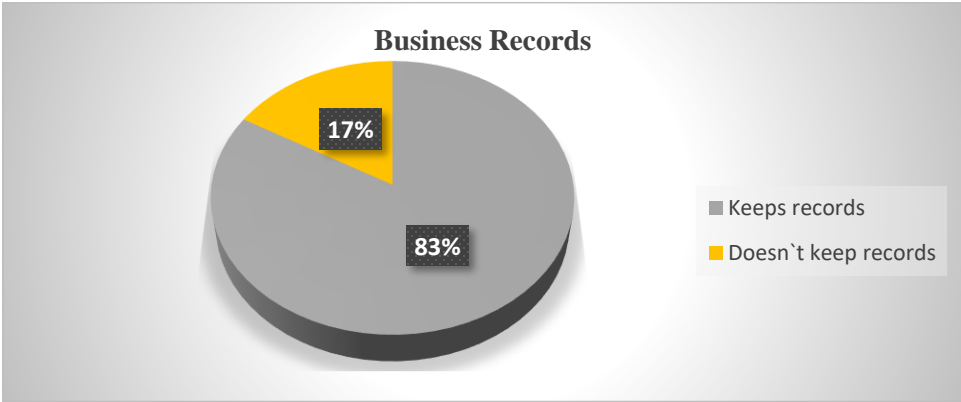


Figure 4.5 shows that 83% of respondents kept records for their businesses which represented 156 while 17% of respondents representing 31 did not keep records for their businesses. Majority of the respondents were found to keep records for their businesses in some form which shows some level of financial literacy.

**4.2.7 How Business Records Are Kept**

Study participants who kept records for their businesses were asked to state how they keep them and below are results as shown in figure 4.6:

**Figure 4.6: Business records**

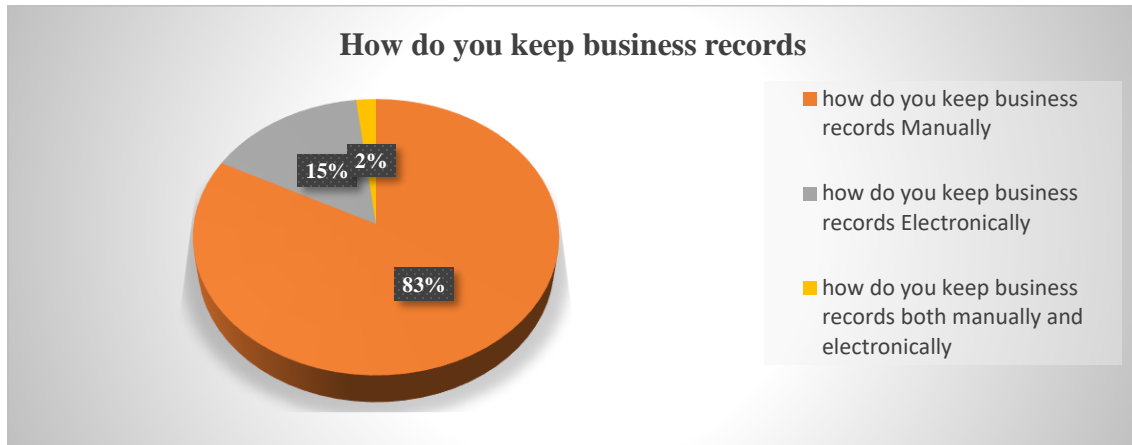


Figure 4.6 reveals that 83% of respondents which represented 129 kept business records manually; 15% kept their business records electronically representing 24; and 2% kept their business records both manually and electronically representing 3 respondents.

#### **4.2.8 Respondents` Perception on Registration of Businesses with PACRA and ZRA**

Respondents were asked to state whether they thought registering their businesses with PACRA and ZRA was beneficial or not. Below are the results as indicated in figure 4.7.

**Figure 4.7: Business Registration**

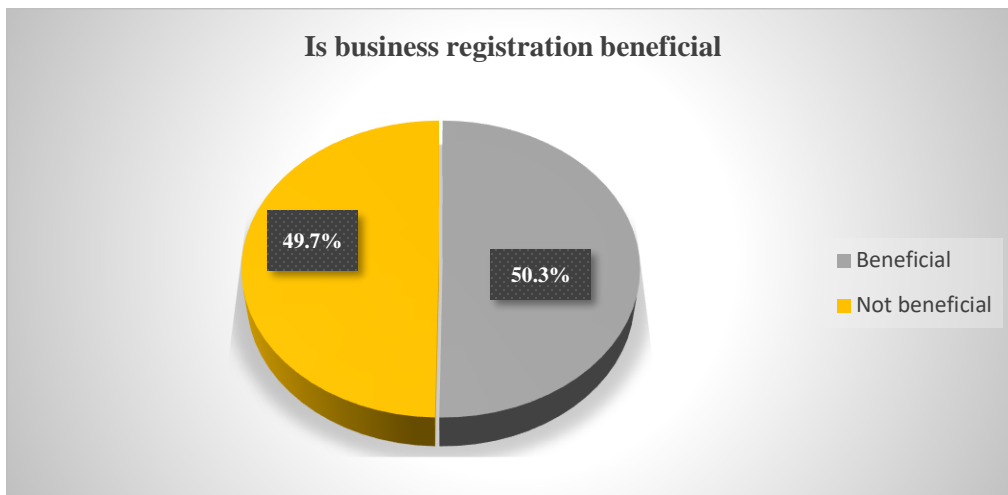


Figure 4.7 shows that 50.3% which represents 94 respondents believed that it was beneficial to have their businesses registered with PACRA and ZRA while 49.7% representing 93 respondents were of the view that it was not beneficial to have their businesses registered.

#### 4.2.9 Respondents` Perception on Benefits of Registration of Businesses

Respondents who indicated that it was beneficial to register their businesses were asked to state registering their business would be beneficial to them. The following are results in the figure 4.8:

**Figure 4.8:** Benefits of business registration



Figure 4.8 shows that 27.8% representing 27 respondents indicated that business registration would enable them to apply for business loans; 9.3% which represented 9 respondents were of the view that they can have training for business; 40.2% representing 39 respondents indicated that they that they can be supplying goods and services to other companies; and 22.7% which represented 22 respondents indicated that they can collaborate and partner with other companies or businesses.

#### 4.2.10 Annual Sales

Respondents were asked to state the sales they make annually in their businesses and the following results were given as shown in figure 4.9 below:

**Figure 4.9:** Annual Sales

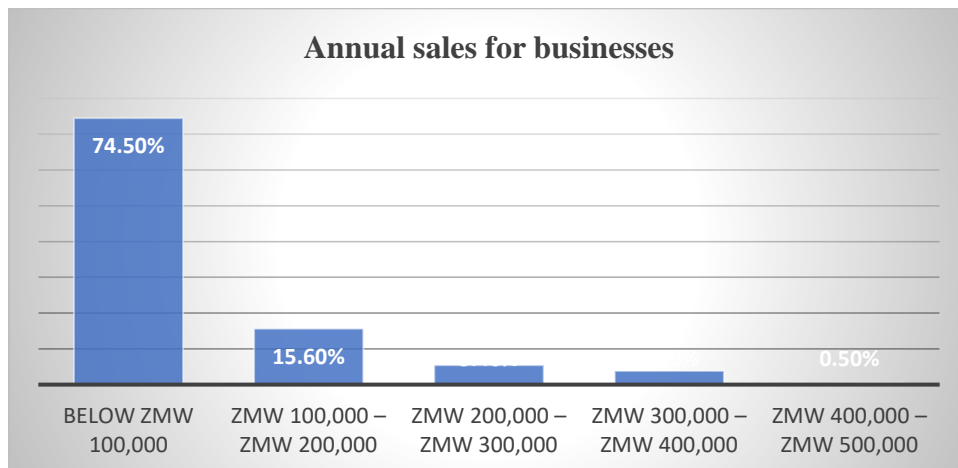


Figure 4.9 shows that 74.5% representing 139 respondents indicated that they had annual sales of Below ZMW 100,000; 15.6% which represented 29 respondents had annual sales of ZMW 100,000 – ZMW 200,000; 5.4% representing 10 respondents had annual sales of ZMW 200,000 – ZMW 300,000; 3.8% representing 7 respondents had annual sales of ZMW 300,000 – ZMW 400,000; and 0.5% representing 1 respondent had an annual sale of ZMW 400,000 – ZMW 500,000. One (1) respondent did not indicate their annual sales.

#### 4.2.11 Monthly Business Rentals

Study participants were asked to state the business monthly rentals they paid, and results are shown as indicated in table 4.5 below:

**Table 4.5:** Monthly Business Rentals

<b>Amount</b>	<b>Frequency</b>	<b>Percent</b>	<b>Cumulative Percent</b>
Below ZMW 1,500	68	36.4	36.4
ZMW 1,500- ZMW 3,000	98	52.4	88.8
ZMW 3,000 - ZMW 4,500	20	10.7	99.5
ZMW 4,500 - ZMW 6,000	1	.5	100.0
<b>Total</b>	<b>187</b>	<b>100.0</b>	

Table 4.5 shows that 68 respondents representing 36.4% paid monthly rentals of below ZMW 1,500; 98 respondents representing 52.4% paid monthly rentals of ZMW 1,500 – ZMW 3,000; 20 respondents representing 10.7% paid monthly rentals of ZMW 3,000 – ZMW 4,500; and 1 respondent representing 0.5% paid monthly rentals of ZMW 4,500 – ZMW 6,000.

#### 4.2.12 Business Loan

Respondents were asked to state whether they had ever gotten a loan for their business or not and the following as the results as indicated in figure 4.10 below:

**Figure 4.10:** Loan for the business

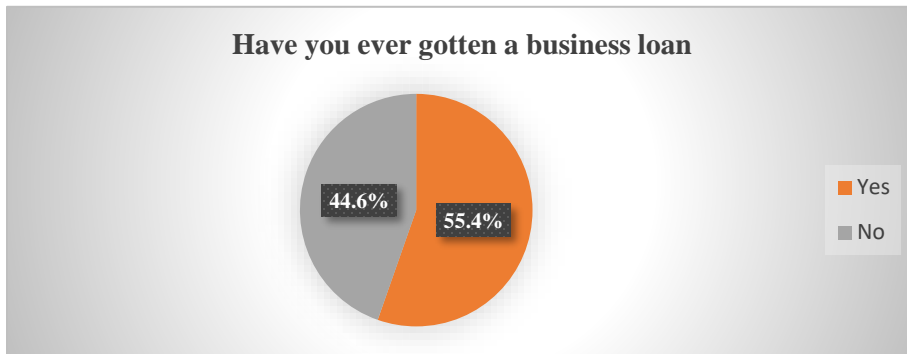


Figure 4.10 shows that 103 respondents representing 55.4% had gotten loan for their business before while 83 respondents representing 44.6% had never gotten loan for their businesses. 1 respondent did not indicate to this question.

#### 4.2.13 Source of Business Loan

Respondents who indicated that they had gotten business loan before were asked to indicate the source from which they got the loans. Below are the results as indicated in figure 4.11:

**Figure 4.11:** Source of business loans

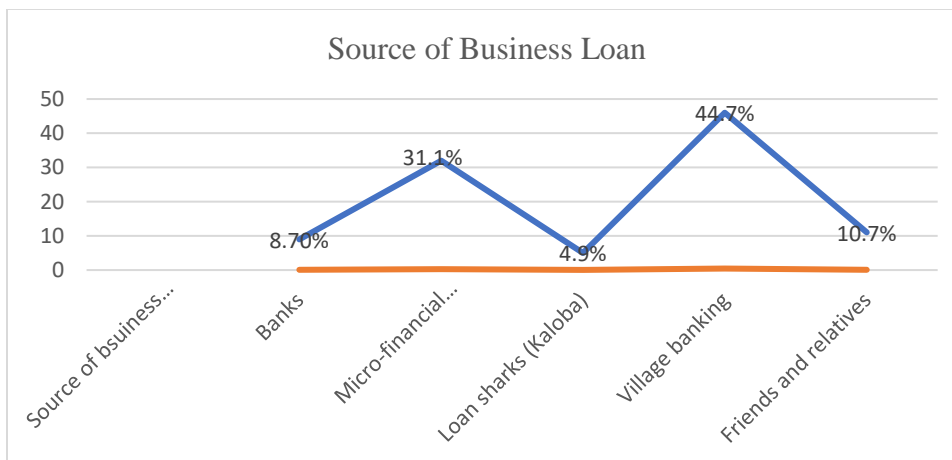


Figure 4.11 shows that 9 respondents representing 8.7% got their loans from banks; 32 respondents representing 31.1% got their loans from micro-financial institutions; 5 respondents representing 4.9% got their loans from Loan sharks (Kaloba); 46 respondents representing 44.7% got their loans from village banking; and 11 respondents representing 10.7% got their loans from friends and relatives.

#### 4.2.14 Business Training

Respondents were asked to indicate whether they had training in business or not. Below are results as shown in figure 4.12:

**Figure 4.12:** Business Training

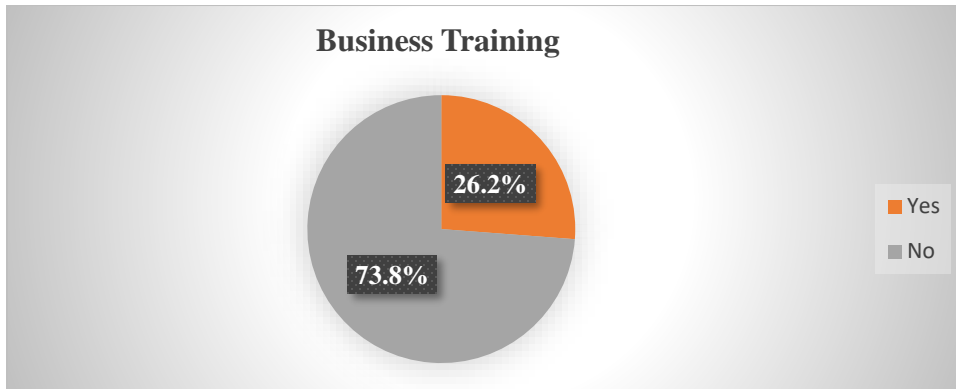


Figure 4.12 reveals that 49 respondents representing 26.2% had training in business while 138 respondents which represented 73.8% did not have training in business.

#### 4.2.15 Satisfaction with Government Services (i.e condition of the market)

Study participants were asked to indicate whether they were thought Government services were worth paying taxes for. The following are the results as indicated in figure 4.13:

**Figure 4.13:** Satisfaction with Government Services

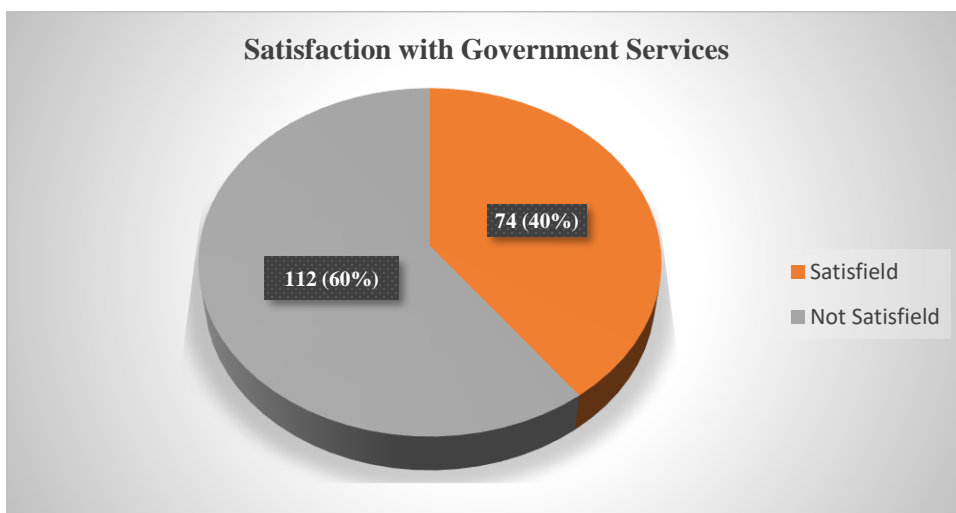


Figure 4.13 shows that 112 respondents representing 60% were not satisfied with Government services and did not think they were worth paying taxes for while 74 respondents which

represented 40% were satisfied with government services and thought that they were worth paying taxes for.

### 4.3 Formal SMEs` Competitive Advantage Over Informal SMEs

Respondents were asked to state their opinions with regards to sales between registered and unregistered enterprises as well as to state if their businesses had any partnerships and the type of partnerships, they were involved in. This was done to assess the extent to which they benefit or miss out on services expected to be enjoyed by formalised enterprises.

#### 4.3.1 Respondents` Awareness of Registered SMEs with PACRA and ZRA

Respondents were asked to state if they personally knew enterprises that were registered with PACRA and ZRA. Below are the results in table 4.6:

**Table 4.6:** Respondents` Awareness of registered SMEs

Response	Frequency	Percent	Cumulative Percent
Yes	134	71.7	71.7
No	53	28.3	100.0
Total	187	100.0	

Table 4.6 reveals that 134 respondents representing 71.7% were aware of SMEs that are registered with PACRA and ZRA while 53 respondents representing 28.3% were not aware of PACRA and ZRA registered SMEs.

#### 4.3.2 Respondents` Opinion on Sales for Registered SMEs Make

Respondents were asked whether they think PACRA and ZRA registered SMEs make more profits than unregistered ones. Below are the results in figure 4.14:

**Figure 4.14:** Sales and profits for registered SMEs

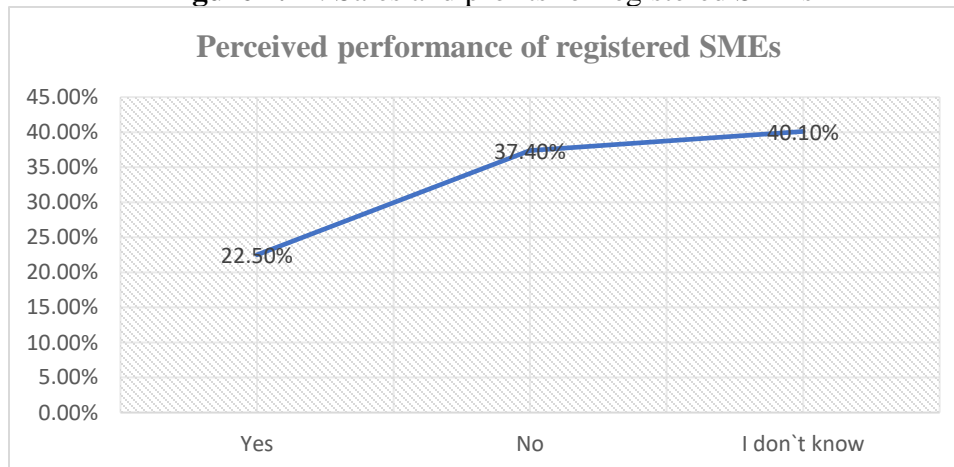


Figure 4.14 shows that 42 respondents representing 22.5% were of the view that PACRA and ZRA registered SMEs made more profits than unregistered ones; 70 respondents representing 37.4% did not think PACRA and ZRA registered SMEs made more profits than unregistered ones; and 75 respondents which represented 40.1% did not know if PACRA and ZRA registered SMEs made more profits than unregistered ones.

#### 4.3.3 Respondents` Opinion on Why Registered SMEs Make More Sales

Respondents who opined that PACRA and ZRA registered SMEs made more profits than unregistered ones were asked to give reasons why they thought so. Below are results as indicated in figure 4.15:

**Figure 4.15:** Reasons for perceived profits for registered SMEs

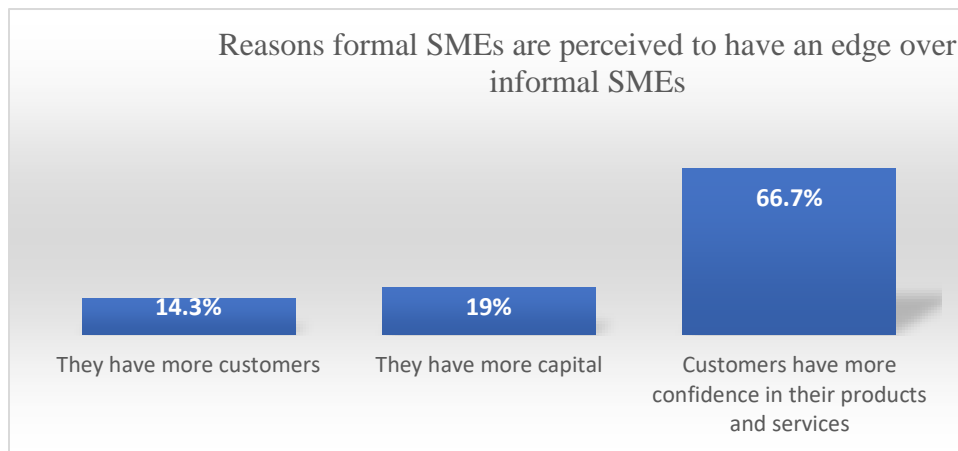


Figure 4.15 shows 6 respondents representing 14.3% indicated that registered SMEs make more profits than registered ones because they have more customers; 8 respondents representing 19.0% were of the view that more capital among registered SMEs was attributed to their profits; and 28 respondents which represent 66.7% indicated registered SMEs make more profits than unregistered ones because customers have more confidence in their goods and services.

#### 4.3.4 Business Partnerships

Respondents were asked to state if their businesses had any partnerships and below are results in figure 4.16:

**Figure 4.16: Partnerships**

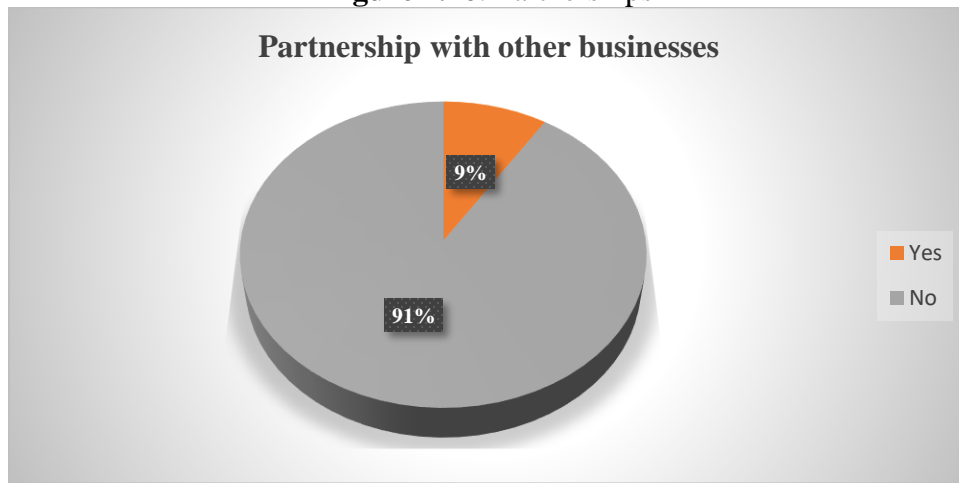


Figure 4.16 shows that 9% respondents' businesses representing 17 had partnerships with other businesses while 91% respondents' businesses representing 170 did not have partnerships with other businesses.

#### **4.3.5 Type of Business Partnerships**

Respondents that indicated that their businesses had partnerships, were asked to state the type of partnerships they had. Results are shown below in figure 4.17:

**Figure 4.17: Type of partnerships**

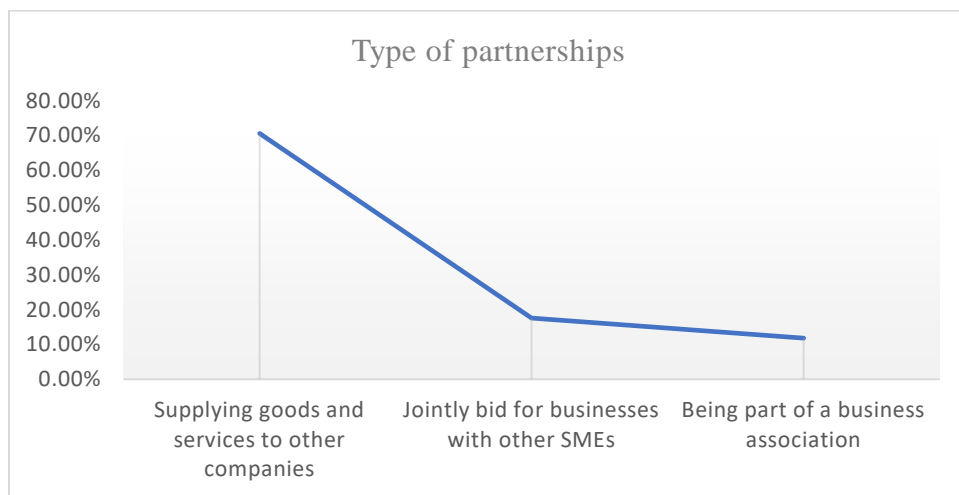


Figure 4.17 shows that 12 respondents which represented 70.6% were supplying goods and services to other companies; 3 respondents representing 17.6% could jointly bid for business with other companies; and 2 respondents which represented 11.8% were part of a business association.

#### 4.4 Government's Support of Informal SMEs' Transition to the Formal Economy

Respondents were asked to state whether they were aware of Government's support for the SMEs and how to access the support and the type of support they required as well as to rate the Government efforts in supporting SMEs. This was done to assess the extent to which Government's support for SMEs were either accessed or not by SMEs.

##### 4.4.1 Respondents' Awareness of Government's Support for SMEs

Respondents were asked if they were aware of the support for their businesses they could get from Government. The results are shown below in figure 4.18:

**Figure 4.18:** Government support for SMEs

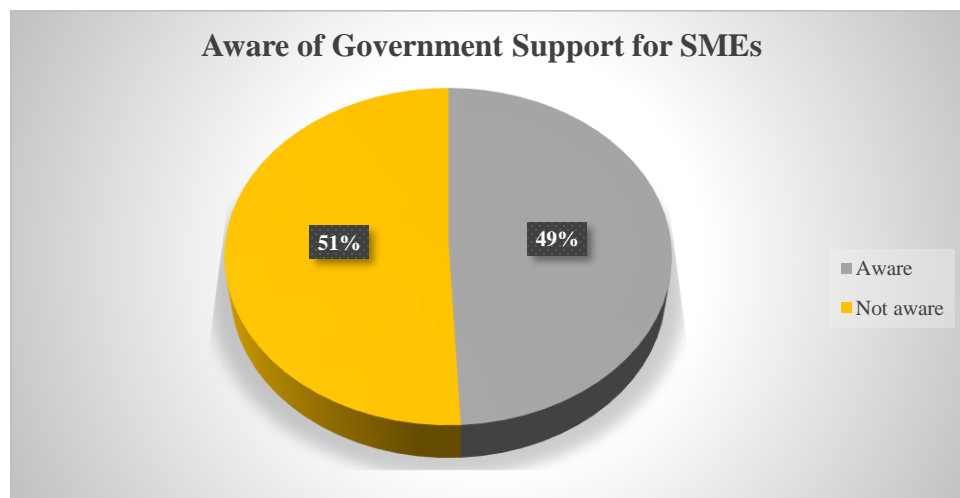


Figure 4.18 reveals that 49% of respondents representing 92 were aware of government support for SMEs, while 51% representing 95 respondents were not aware government support for SMEs.

##### 4.4.2 Access of Government's Support for SMEs

Respondents who indicated that they were aware of Government's support for SMEs were asked to state if they knew what to do to access Government support for SMEs. The results are presented below as indicated in figure 4.19:

**Figure 4.19: Knowledge – Access to Government Support**

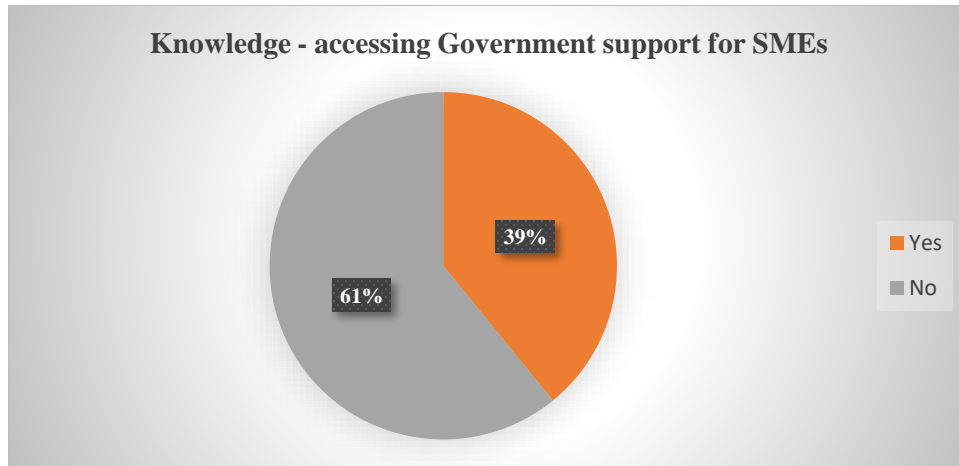


Figure 4.19 reveals that 39% of respondents interviewed representing 36 were aware of what they needed to do to access Government support for SMEs while 61% of interviewed respondents representing 56 were not aware.

#### **4.4.3 Business Support Required by Respondents**

Respondents were asked to state the type of support they needed for their businesses and the results are shown below in figure 4.20:

**Figure 4.20: Required business support.**

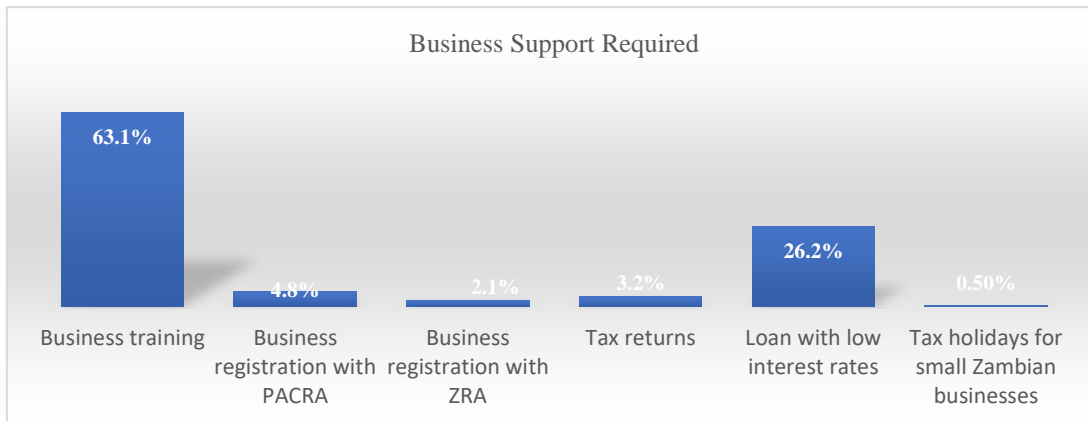


Figure 4.20 shows that 111 interviewed respondents representing 63.1% indicated that they needed business training; 9 respondents representing 4.8% indicated that they needed support with regard to business registration with PACRA; 4 respondents which represented 2.1% indicated that they need support with business registration with ZRA; 6 respondents which represented 3.2% indicated that they needed support with regard to tax returns; 49 respondents representing 26.2% indicated

that they needed loan with lower interest rates; and 1 respondent representing 0.5% indicated that they needed tax holidays doe small Zambian businesses.

#### 4.4.4 Government`s Efforts in Supporting SMEs

Respondents were asked if they thought the Government was doing enough regarding supporting SMEs. Results are shown below as indicated in figure 4.21.

**Figure 4.21:** Government Support for SMEs

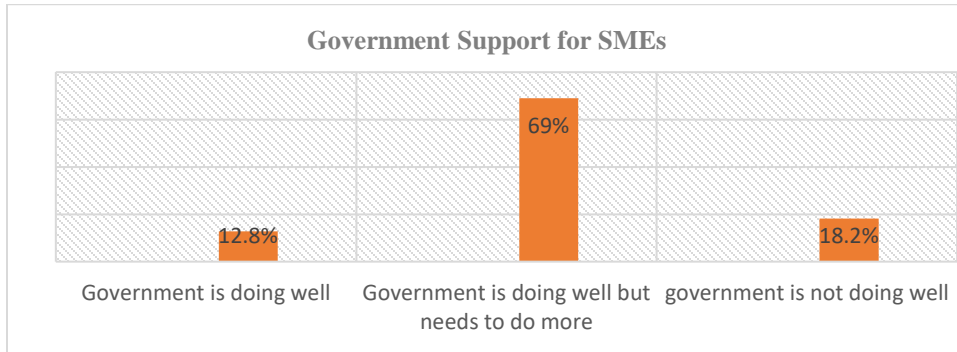


Figure 4.21 shows that 24 interviewed respondents representing 12.8% were of the view that the government was doing more than enough; 129 respondents representing 69.0% were of the view that the government was doing well but needed to improve; and 34 respondents representing 18.2% were of the view that the government was not doing well.

## CHAPTER 5

### QUALITATIVE DATA PRESENTATION

The researcher conducted interviews to explore perceptions to better understand factors behind non formalisation of SMEs operating from Chilenje Market. The researcher interviewed seven (07) respondents who comprised of males and females from different institutions which were selected as follows (1) ILO, (2) ZDA, (3) ZRA, (4) PACRA, (5) CEEC, (6) Ministry of Small and Medium Enterprises, and (7) Ministry of Labour and Social Security. One individual was interviewed from each of the seven (7) institutions selected. Therefore, a total of seven (7) key informant respondents were interviewed and all respondents were given codes for their easier identification during the presentation and discussion of results. The reason for assigning codes to them was to avoid using their names which is a way of compliance to ethical standards. Table 8 below therefore, shows participants` institutions and codes.

**Table 5.1:** Participants` Codes

<b>Institution</b>	<b>Gender (M/F)</b>	<b>Participant`s Code</b>
ILO	M	ILON-1
ZDA	F	DAZ-2
ZRA	M	RAZ-3
PACRA	F	CRAPA-4
CEEC	M	CECE-5
Ministry of Small and Medium Enterprises	M	SMEM-6
Ministry of Labour and Social Security	F	MLSS-7

The table above indicates the institution which key informant respondents represented, their gender, and their code. The code for ILO is ILO-1; ZDA is DAZ-2; ZRA is RAZ-3; PACRA is CRAPA-4; CEEC is CECE-5; Ministry of Small and Medium Enterprises is SMEM-6; and Ministry of Labour and Social Security is MLSS-7. Out of the total of 7 participants, 4 were males while 3 were females.

## 5.1 Role of informal SMEs in the national economy

Respondents were asked what they thought was the role of informal SMEs in the national economy and all respondents had one thing in common that SMEs in the informal economy played a significant role in the national economy. One respondent said:

*“the contribution of informal SMEs is something we cannot underscore because they are the majority, if you look at the way Zambia is structured, there are very few industries but the majority are SMEs and these are the guys who are doing fabrication and others are into hardware stuff, so the issue is as they move to provide services and getting small loans and buying some goods abroad, and bring them in, that`s how the economy is moved, so their contribution cannot be underscored” (CECE-5).*

The second respondent had a similar view regarding the role of informal SMEs in the national economy and had the following to say:

*“SMEs as you know are in the majority and you will find that they are the largest, statistics actually indicate that 70% of workers in the world are found among SMES in the informal sector, so this just shows that this is where huge chunk of people are found, so its contribution to the national development is that, that`s where jobs are and over 70% of people are found there... from the government point of view, there are benefits as well in terms of collection of revenue from SMEs for government to be able to provide social services for its citizens” (ILON-1).*

SMEs in the informal sector are also believed to provide a base or foundation upon which business ideas are birthed and practiced. In line with this thought, the one of the respondents had the following response:

*“Most of them create jobs, the 2020 labour force survey indicates that over 60% of the Zambian population operates in the informal economy as workers. They are also a breeding ground for innovation because am just starting a small business, I don`t know how this business is going to grow, so it`s from this business that am going to upscale, and it is also from this same business that others will be able to identify that what am doing is something that can become big. So they are a first point in innovation which is required for national economy” (MLSS-7).*

## **5.2 Graduation of informal enterprises to the formal economy**

When it came to the importance of informal enterprises to graduate to the formal economy, interview respondents highlighted two important points. The first point was that businesses are only able to grow when they have access to finance or credit and financial institutions only provide their services to registered businesses as risks are less because they can be tracked and traced. One of the respondents had the following response:

*“It is important for SMEs to graduate into formal sector, one of the reasons is for them to have access to credit, no one can give credit to an institution that is not formalised, when they are formalised, it means they have licenses, they are paying taxes, that means they have the TPIN, so for them to graduate into the formal sector, that means they will be able to access services like credit from government or private institutions ....institutions can only work with them if they are formalised and have documentations, they are traceable, they are organized and can give them business development services, trainings, financing, link them to other systems, networks and markets and be able to contribute to national development” (ILON-1).*

The second point that came out of the interviews was about the social security of SMEs` owners and the workers therein that is at risk for as long as informal SMEs continue operating in the informal sector. This was further elaborated below by one of the respondents:

*“The reason we want them to formalise is because of the dangers that exist in the informal economy, so when you are in the informal sector, it means you are not identified, you are not registered with schemes that register businesses, or you may be registered with PACRA but not registered with schemes which guarantee social protection which have to do with issues of pension and compensation” (MLSS-7).*

## **5.3 Formalisation benefits from SMEs` perspective**

Interviews revealed that there is more to benefit with formalisation for SMEs than when not formalised due to several services and support that can only be accessed by registered businesses. One respondent further expanded on this point by the following response:

*“they stand higher chances of getting opportunities like getting support for financing and business opportunities, there is potential for the business grow and getting Government*

*support and other business support such as Chamber of Commerce, ZDA/CEEC incentives” (RAZ-3).*

The other respondent had the following to say on the benefits that SMEs stand to get if they formalised their businesses:

*“There are a lot of benefits businesses are able to get if they formalised their businesses such as name protection, access to finance, market linkages, so if at all they are formalised, they may be supplying their products to other companies like Pick n Pay which Zambia Development Agency is working with to have MSMEs supply products” (CRAPA-4).*

#### **5.4 Reasons for SMEs operating from the informal economy**

Interviews on why most of the SMEs still operate in the formal sector revealed illiteracy, lack of incentives, poor business management skills, information mismanagement and poor infrastructure as some of the reasons behind a big number of SMEs in the informal economy. One respondent said:

*“illiteracy is one of the reasons why others are still stuck in the informal sector. The other reason is that there hasn’t been too much sensitization on the benefits that business enterprises can get when they are formalised” (CECE-5).*

The other respondent had the view that lack of incentive for business registration and poor infrastructure especially in remote rural areas significantly contributed to non-registration of some SMEs. The following was his response:

*“Most enterprises are still operating in the informal sector, mainly from our perspective is that there is lack of incentives to formalise, for example, the informal sector will see regulations to register and pay taxes as a burden. If for instance am contributing taxes or employing a number of people, what incentives are there for me to formalise or is it just a burden for me without any benefits.....it is also an issue to do with lack of awareness or knowledge about the benefits that they can get when they formalise a business. The other one is poor business management skills that business owners have, at times they don’t even know the difference between capital and profits. The other one is to do with infrastructure like roads especially those SMEs located in remote rural areas that are 100 kilometers away from government offices, it becomes difficult for such SMEs to formalise” (ILON-1).*

The third respondent opined that misinformation about business formalisation played a part about non formalisation of some SMEs and gave the following response:

*“So the biggest cause of most SMEs` failure to formalise is the issue of misinformation, a number of them think that once they formalise, it means that immediately they will now have to start paying a lot of taxes, they will start losing money and there is also the use of third parties in formalisation which create an impression that formalisation is expensive” (SMEM-6).*

### **5.5 Effects of cost of formalisation on informal SME owners**

Interviews on the cost of formalisation revealed that formalisation benefits outweigh costs associated with formalizing. One of the respondents had this to say:

*“I know they may be paying council levies, but I think in initial stages they can make more money than someone whose business is registered because for them, they just remove their operational costs and the rest is their profit, unlike a registered business. So we still encourage businesses to formalise because it`s the right thing to do” (CECE-5).*

The other respondent was also of the view that there is more to benefit when SMEs are registered as opposed for them to remain informal and gave the following response:

*“For me the benefits of being in the formal sector outweighs being in the informal sector. So as ILO we strongly recommend businesses to formalise because they can have access to credit from both government and private institutions, business development services, health insurance through NHIMA, they can get pension, and benefits from social protection” (ILON-1).*

### **5.6 Laws and policies supporting informal SMEs to transition to the formal economy**

Interviews on the laws and policies that support the transition of informal SMEs to the formal economy revealed the following:

*“... the ZDA Act that provided for the creation of ZDA and CEEC Act, and in terms of policy guidance is SME Policy that Government is trying to work on and Government is trying to work on the new Youth Policy. I think these are some of the laws and policies that*

*support formalisation of businesses. However, I think these pieces of laws and policies need to be updated to incorporate current trends” (ILON-1).*

The second respondent on this issue gave the following response:

*“Some of the current laws that speak to that for example is the Zambia Development Agency Act which emphasizes the aspect of supporting Small and Medium Enterprises in their operations and doing business. Secondly, is the CEEC Act which also looks at providing incentives and supporting SMEs through financing. As we speak the Ministry of Small and Medium Enterprises is currently working on what will be referred to as SMEs bill, this one is specifically going to look at what will be created for Small and Medium Enterprises in terms of their existence and their operations country wide” (SMEM-6).*

### **5.7 Government`s support for SMEs` transition to the formal economy in Zambia**

Interviews on whether the Government is doing enough to support transition of the SMEs from informal to the formal sector revealed different views from respondents as others were of the view that the government is doing well while others believed that the Government needed to do more.

One respondent gave the response below:

*“In terms of what the government is doing, they are not very visible, they are not doing a lot to get their message out..... the information is not out there and may need to develop a strategy around communication on how government through various ministries and institutions that are mandated to provide support to SMEs are reaching out. We have ZDA, CEEC, Ministry of SMEs itself, Ministry of Youth and Sports, we also have CDF now which has a component to support SMEs. So people need to know about these opportunities for them to benefit from them” (ILON-1).*

The other respondent was of the view that the Government has not done much but is on the right track due to the programmes being implemented by the government aimed at supporting SMEs.

His response is as follows:

*“.....one of the programmes that we are beginning to work on and we have actually started and already has the approval of the Secretary to the Cabinet is the sensitization of SMEs for them to participate in the procurement of contracts through CDF. All these*

*programmes will help a number of SMEs to be forced to formalise their businesses for them to have access to some of these jobs” (SMEM-6).*

One respondent was of the view that there is need to amend some laws so as to enable government institutions provide better services to support SMEs. Below is what he said:

*“I think they should amend the relevant regulatory laws that govern quasi- government institutions to be more flexible and friendlier to the SMEs who are not compliant. They should also invest more in the Change management and education of the SMEs so that they see the value of transitioning to the formal economy” (RAZ-3).*

### **5.8 Awareness of Government`s support for businesses by informal SME owners**

Interviews on whether SME owners were aware of the support they could get from the government to support their businesses or not, showed the following results:

*“Some might be aware, while others may not. But I think the most aren`t aware of the support government can give, and I also think that some government departments meant to support this cause do not have the relevant skills to handle that role” (RAZ-3).*

The other respondent had the following view:

*“Some SME owners are aware of the support they can get from government for their businesses except that we are coming from a very politicized environment, and this makes some people feel that available government services can only be accessed by politically connected individuals. There is therefore need for more sensitization for the public so that SME owners can get services provided through government ministries and institutions mandated to provide support for SMEs” (MLSS-7).*

A respondent from ZDA believed that Government through ZDA was doing enough to disseminate information to the public about awareness of business owners of the services or support they could get from Government for their businesses. The following response was given:

*“We are doing a lot to sensitize the public on the support ZDA provides to businesses through traditional media and on the internet through our website, but I don`t know the extent to which SMEs are aware of the services and support they can get from us” (DAZ-2).*

## **CHAPTER 6**

### **DISCUSSION OF FINDINGS**

#### **6.1 Educational Level of Respondents**

Results revealed that 8 respondents had a bachelor's degree level of education which represented 4.3%; 33 respondents had diplomas representing 17.6%; 16 had college certificates representing 8.6%; 108 had grade twelve (12) certificates representing 57.8%; 20 had grade nine (9) level of education representing 10.7%; and 2 respondents had grade seven (7) level of education representing 1.1%. majority of respondents had grade twelve (12) certificates followed by diplomas, and grade nine (9). The level of education for business owners has an impact on business owners' decision to either decide to formalise their enterprises or not. The assumption however is that the highly educated business owners will decide to formalise their businesses while lowly educated business owners will stay informal. This is in line with the study by (Jiménez et al, 2015) which revealed that people with tertiary education are more aware of repercussions that come with informal enterprises and as a result often tend to prefer formal to informal enterprises.

The above assumption is disputed by the findings from William (2013) study conducted in Pakistan which revealed that people running informal enterprises were better educated than people working in the formal sector due to higher taxes which educated people were avoiding paying. Much as there could be highly educated people running informal enterprises in Zambia, it is widely believed according to different pieces of literature that majority of people operating in the informal economy in Zambia are of low education.

#### **6.2 Registration of SMEs with PACRA and ZRA**

Results showed that 62 enterprises were registered with PACRA and ZRA representing 33% while 125 enterprises were not registered representing 67%. Respondents whose enterprises were not registered with PACRA and ZRA indicated the following reasons behind their decision not to register their enterprises 24.6% did not know the procedure for registration; 11.8% said it was expensive to register their businesses; 26.7% 50 indicated that their businesses were too small to be paying taxes; and 5.3% indicated that it was time consuming to register their businesses.

All the reasons provided by all respondents for not registering their businesses suggested that respondents did not have information about what is involved in business registration with ZRA

and PACRA as well as understanding of the benefits that come with enterprise formalisation. A business enterprise in the informal economy can hardly access credit and other services such as business training from both the government and the private sector which are critical for the growth of any business. The above view is supported by Mugisa (2021) who argues that formalisation enables business owners to have commercial contracts, membership in trade associations, legal ownership of their places of business and increase their productivity, enjoy tax breaks and incentive packages to increase their competitiveness, protection against creditors and clear bankruptcy rules, and social protection. Mugisa seems to suggest formalisation benefits come immediately a business is formalised which is far from reality as formalisation is only one aspect of the business management and formalisation must be combined with other aspects of the business such as management skills and accounting.

The above view by Mugisa (2021) is supported by one expert who said, *“they stand higher chances of getting opportunities like getting support for financing and business opportunities, there is potential for the business grow and getting Government support and other business support such as Chamber of Commerce, ZDA/CEEC incentives”*. The other expert was also of the similar view and *“there a lot of benefits businesses are able to get if they formalised their businesses such as name protection, access to finance, market linkages, so if at all they are formalised, they may be supplying their products to other companies like Pick n Pay which Zambia Development Agency is working with to have MSMEs supply products”*.

### **6.3 Respondents` Perception on Benefits of Business Registration with PACRA and ZRA**

Results show that 50.3% of respondents believed that it was beneficial to have their businesses registered with PACRA and ZRA while 49.7% were of the view that it was not beneficial to have their businesses registered. The results indicate that several SMEs` owners understood benefits of registering their businesses irrespective of whether their own businesses were registered not, and this showed potential and willing to have their businesses registered in the future while others did not understand.

A study by Koto (2015) in Ghana revealed that the informal sector in Ghana was dominated by lowly educated people who did not have employable skills. Although this may not be the case, this study found that most respondents had education levels of grade 12 certificates which may be too

basic to understand for them to understand benefits of enterprise formalisation such as participating in public biddings and access to credit if not taught by other people. This, therefore, could explain the response that business registration was not beneficial.

An expert spoken to on the benefits of business registration, said *“It is important for SMEs to graduate into formal sector, one of the reasons is for them to have access to credit, no one can give credit to an institution that is not formalised, when they are formalised, it means they have licenses, they are paying taxes, that means they have the TPIN, so for them to graduate into the formal sector, that means they will be able to access services like credit from government or private institutions”*. Proponents of enterprise formalisation make formalisation look too simplistic as though benefits are realized immediately yet they are not. Formalisation alone for instance cannot make an SME have access to credit from most private financial institutions because they also require collateral which most SMEs may not have despite being formalised. It is therefore important to provide SMEs with full information about formalisation so that they make informed decisions. Talking about the same formalisation, as Benjamin (2014) states formalisation is attractive if its benefits far outweigh the costs. It should however be noted that benefits do not always come immediately and this has the potential to make enterprises that formalise to slide back into informality if only half baked information is provided.

#### **6.4 Business Loans**

Results show that 103 respondents representing 55.4% had gotten loans for their business before while 83 respondents representing 44.6% had never gotten loan for their businesses. From 55.4% (103) who had accessed loans for their businesses, 8.7% got their loans from banks; 31.1% got their loans from micro-financial institutions; 4.9% got their loans from Loan sharks (Kaloba); 44.7% got their loans from village banking; and 10.7% got their loans from friends and relatives.

These results suggest that respondents who got their loans from banks and micro-financial institutions must have been among respondents whose business enterprises were registered while loans from loan shark (Kaloba), village banking and relatives and friends must have included several respondents whose business enterprises were not registered. Formalisation should therefore be more attractive beyond the promise of access to credit by business owners as some of them are able to access credit through the famous village banking schemes without graduating to the formal economy. Benjamin (2014) has a similar view and state that formalisation is attractive

if its benefits far outweigh the costs and it may not be attractive on the other hand if it does not lead to visible benefits even if the costs are minimal because firms would prefer staying informal.

### **6.5 Business Training**

Results reveal that 49 respondents representing 26.2% had training in business while 138 respondents which represented 73.8% did not have training in business. Lack of business training for most respondents could partly be attributed to low number of registered businesses because business training usually comprises of dealing with challenges of formalizing small enterprises and how to stay in compliance with existing laws as formalised enterprises.

Further business training is very important as it makes informal business owners aware of the risks, challenges, and competition they have from formalised and established businesses which can easily wipe out their businesses. Kosh (2019) provides similar sentiments that informal SMEs are under threat of extinction because they usually do not invest in new technology or upgrading or learning new skills critical for improved provision of goods and services which make formal enterprises have a competitive edge of them. Business training is key for survival of informal SMEs.

### **6.6 Satisfaction with Government Services (i.e condition of the market)**

Results showed that 112 respondents representing 60% were not satisfied with Government services and did not think they were worth paying taxes for while 74 respondents which represented 40% were satisfied with government services and thought that they were worth paying taxes for. Formalisation is quite expensive due to taxes that are paid and if formalisation must be attractive, it must be incentivized by ensuring that business owners enjoy public services and convinced that taxes are put to good use.

Andrade (2014) in his study in Peru, found that most of the businesses which were registered, their registration licenses were not renewed for the year that followed. Although finding out the number of businesses which were once formalised and slid back into informality was beyond the scope of this study, there is a possibility that some businesses slid back to informality because their owners did not see any benefits other than paying taxes in the formal sector.

### **6.7 Respondents` Views on Registered SMEs with PACRA and ZRA**

Results revealed that 42 respondents representing 22.5% were of the view that PACRA and ZRA registered SMEs made more profits than unregistered ones; 70 respondents representing 37.4% did not think PACRA and ZRA registered SMEs made more profits than unregistered ones; and 75 respondents which represented 40.1% did not know if PACRA and ZRA registered SMEs made more profits than unregistered ones.

22.5% respondents who thought that formalised enterprises made more profits than unregistered ones probably formed their opinions based on the few registered businesses they observed that were probably doing better. 37.4% of respondents who thought registered businesses did not make more profits than unregistered ones and 40.1% who did not know, had probably observed that there was no difference between in terms of sales between few registered businesses and their unregistered. This may have contributed to other business owners` decision not to have their businesses registered because they do not understand that formalisation benefits sometimes do not always come immediately. Campos (2018) supports this view and argues that business registration alone does not lead to profit making but business training such as accounting, customer care and marketing does help.

### **6.8 Awareness of Government`s Support for SMEs**

Results revealed that 49% of respondents representing 92 were aware of government support for SMEs, while 51% representing 95 respondents were not aware of government support for SMEs. From 49% (92) respondents who were aware of government support for SMEs, results indicated that 39% (36) were aware of what they needed to do to access Government support for SMEs while 61% (56) were not aware. Results suggest that it is important to have a deliberate communication strategy to ensure that business owners are sensitized on the support they can get from the government for their businesses and the procedure involved in accessing the said support.

According to literature, the government plays an important role in the success of SMEs (Jauriyah, 2020). However, SMEs need to be aware and recognise the support they could get from the government if the support provided will be of any help to them. One of the experts interviewed shared similar views and said, *“some SME owners are aware of the support they can get from government for their businesses except that we are coming from a very politicized environment, and this makes some people feel that available government services can only be accessed by*

*politically connected individuals*”. It is therefore very important to sensitize the public on the available support and services for SMEs. Some of the services have the capacity to encourage SMEs in the informal sector to migrate to the formal economy because certain services may only be accessed by formalised businesses.

### **6.9 Business Support Required by Respondents**

Results according to figure 22 in chapter four showed that 111 respondents representing 63.1% indicated that they needed business training; 9 respondents representing 4.8% indicated that they needed support with regard to business registration with PACRA; 4 respondents which represented 2.1% indicated that they need support with business registration with ZRA; 6 respondents which represented 3.2% indicated that they needed support with regard to tax returns; 49 respondents representing 26.2% indicated that they needed loan with lower interest rates; and 1 respondent representing 0.5% indicated that they needed tax holidays for small Zambian businesses. Results suggest that the support required by most respondents was business training which is key for business formalisation. The need for loans with low interest rates had the second biggest number of respondents who advocated for it, and this has the capacity to motivate informal SMEs to formalise once it is available because any form of loan from an established institution will require applicants to have formalised businesses.

Campos (2018) commenting on business training in his study says, more than 70% of firms which were provided with business training had registered their businesses out of which about 10% also registered for tax remittance. It should be noted that not every owner of a non registered business does not have business training or knowledge on benefits of formalisation, other business owners intentionally decide against formalising their business for other reasons in spite of their understanding of pros and cons of enterprise formalisation.

### **6.10 Government's Efforts in Supporting SMEs**

Figure 23 in chapter four showed that 12.8% of respondents were of the view that the government was doing more than enough; 69.0% respondents were of the view that the government was doing well but needed to improve; and 18.2% were of the view that the government was not doing well. Results indicated that most of the respondents were of government's support for SMEs although much more was expected and dissatisfaction that the government was not doing well at all.

An expert commenting on the same said *“the information is not out there and may need to develop a strategy around communication on how government through various ministries and institutions that are mandated to provide support to SMEs are reaching out. We have ZDA, CEEC, Ministry of SMEs itself, Ministry of Youth and Sports, we also have CDF now which has a component to support SMEs. So, people need to know about these opportunities for them to benefit from them”*. Ulyseas (2018) estimated that 48.8% of informal firms would not survive if left to operate in the formal economy if not supported. This implies the importance and need for government to step in and provide support for SMEs and aid them graduate into the formal sector and this support needs to be communicated so that members of the public are aware of the support and how to access the support being provided.

### **6.11 Reasons for SMEs operating from the informal economy**

Interviews on why most of the SMEs still operate in the formal sector revealed illiteracy, lack of incentives, poor business management skills, information mismanagement, lack of incentive for business registration and poor infrastructure especially in remote rural areas significantly contributed to non-registration of some SMEs. Nuwagaba (2015) in a study done in Nigeria observed that infrastructure such as bad in form of bad buildings, poor roads, and little formal education by entrepreneurs made it difficult for SMEs operations. Challenges cited and observed by Nuwagaba are not only peculiar to Nigeria but are equally common even in Southern African countries which include Zambia and could influence formalisation of business enterprises.

One of the experts interviewed provided similar insights on why SMEs operate in the informal sector and the said *“Most enterprises are still operating in the informal sector, mainly from our perspective is that there is lack of incentives to formalise, for example, the informal sector will see regulations to register and pay taxes as a burden. If for instance am contributing taxes or employing a number of people, what incentives are there for me to formalise or is it just a burden for me without any benefits .....it is also an issue to do with lack of awareness or knowledge about the benefits that they can get when they formalise a business. The other one is poor business management skills that business owners have, at times they don` t even know the difference between capital and profits. The other one is to do with infrastructure like roads especially those SMEs located in remote rural areas that are 100 kilometers away from government offices, it becomes difficult for such SMEs to formalise”*.

Mugisa (2021) in the previous chapter presented contrasting views to this study's findings and suggested that bureaucratic procedures for business registrations and formalisation benefits which do not come immediately while they are expected to pay taxes and other fees for operating in the formal sector are challenges that contribute to other SMEs' owners' decisions to stay informal.

### **6.12 Effects of cost of formalisation on informal SME owners**

SMEs' decisions to formalise to a large extent depends on costs and benefits involved in the process. The cost of formalisation could be twofold, firstly it could be costs that arise due to payment of taxes and registration fees for the business and second one could come about due to missed opportunities on the account that the business is not formalised. One expert talking about formalisation costs such as taxation said *"I think in initial stages they can make more money than someone whose business is registered because for them, they just remove their operational costs and the rest is their profit, unlike a registered business. However, they cannot grow beyond a certain point because they can't participate in public bidding for instance. So, we still encourage businesses to formalise because it's the right thing to do"*. There is a limit regarding the extent to which an informal business can grow due to limited or low productivity which characterizes enterprises in the informal economy.

The International Labour Organisation expands on the challenges of low productivity which is more prevalent among informal enterprises compared to their formalised counterparts and argues that informal businesses tend to have lower margins and often operating in saturated markets which rarely have the absorption capacity of significant compliance costs (ILO, 2021). Low productivity is therefore cost for staying informal and should act as a drive for informal businesses to formalise.

### **6.13 Laws and Policies supporting informal SMEs to transition to the formal economy**

It is very important for the government to come up with deliberate policies to help or facilitate the transition of informal SMEs to the formal economy. Commenting on the government policies supporting SMEs, an expert said *"the ZDA Act that provided for the creation of ZDA and CEEC Act, and in terms of policy guidance is SME Policy that Government is trying to work on, and Government is trying to work on the new Youth Policy. I think these are some of the laws and policies that support formalisation of businesses"*. It is therefore sufficing to say that Zambia has policies and laws that would adequately support and aid transition of informal SMEs to the formal economy provided they are implemented very well.

The International Labour Organisation argues that untaxed informal enterprises lead to reduced tax base which consequently makes it difficult to provide public goods and services for the citizens and creation of culture of compliance and social cohesion necessitates the need for government laws and policies to facilitate transition of enterprises from informal to the formal economy (ILO, 2021). It is therefore in the interest of any government to have informal SMEs graduate into the formal economy as it makes SMEs more productive and contribute to the revenue basket of the economy. Further, it makes citizens working in the informal economy have better jobs with better working conditions of which the government still gets the credit for. From the formal workers and enterprises` point of view, informal economy leads to unfair competition from untaxed informal enterprises and informal workers (ILO, 2021).

Another expert interviewed on the laws and policies supporting SMEs formalisation echoed the other expert`s views and said *“Some of the current laws that speak to that for example is the Zambia Development Agency Act which emphasizes the aspect of supporting Small and Medium Enterprises in their operations and doing business. Secondly, is the CEEC Act which also looks at providing incentives and also supporting SMEs through financing... the Ministry of Small and Medium Enterprises is currently working on what will be referred to as SMEs bill, this one is specifically going to look at what will be created for Small and Medium Enterprises in terms of their existence and their operations country wide”*. The other reason warrants laws and policies from the government to aid formalisation of SMEs could be as argued by the Williams (2014) that informal enterprises avoid paying taxes and compliance to other regulations like labour laws which enable them to undercut prices for their goods and services to the disadvantage of the formal firms who eventually lose out their market share.

#### **6.14 Summary**

The purpose of this chapter was to discuss the findings of the study presented in chapter four and five which were focused on the investigation of factors which contribute to hindrance of Small and Medium Enterprises formalisation in Chilenje Market of Lusaka District. The discussion was that factors like business owners` education, business training for enterprise owners, awareness of government services, cost of formalisation, levels of satisfaction for government services, and laws and policies on enterprise formalisation all contributed or influenced business owners` decisions to either formalise their enterprises or stay and operate informally.

## CHAPTER 7

### CONCLUSIONS AND RECOMMENDATIONS

#### 7.1 Introduction

This study focused on factors which hinder SMEs` formalization in Chilenje Market of Lusaka District and provided substantial understanding of formalisation challenges faced by SMEs as presented in the previous chapter in which the discussion and analysis of the study`s findings were done. This chapter looked at the conclusion and recommendations as well as proposed future research to comprehensively understand issues around SMEs` formalisation.

The aim of this study was to investigate factors which hinder SMEs` formalization in Chilenje Market of Lusaka District by identifying factors that promote SMEs to operate in the informal economy, analyzing the competitive advantage that formal SMEs have over informal SMEs, and finding out if the legal environment supports informal SMEs` transition to the formal economy.

Questions that guided the study were as follows:

- i. What factors promote SMEs to operate in the informal economy?
- ii. Do formal SMEs have competitive advantage over informal SMEs?
- iii. Does the legal environment support informal SMEs` transition into the formal economy?

#### 7.2 Conclusions

Formalisation of SMEs in Chilenje Market of Lusaka district is associated with several factors as presented in this study. The level of education for enterprise owners was found to be directly linked to enterprise owner`s decisions to either formalise their businesses or not. The other factor that had an impact on enterprise formalisation was the awareness of government services. Awareness of government services and the procedures involved in accessing government support which in most cases forces enterprise owners to formalise their enterprises contributed to the state of enterprise formalisation. The cost of formalisation for registered businesses was also found to be a significant factor that contributed to non formalisation of some business enterprises. The study further revealed that levels of satisfaction for government services and laws and policies on enterprise formalisation also contributed or influenced business owners` decisions to either formalise their enterprises or not.

### **7.3 Recommendations**

The study findings revealed several issues which warranted the researcher`s recommendation as stipulated below:

#### **7.3.1 Business Training for Enterprise Owners**

The government through the Ministry of Small and Medium Enterprises should consider offering business training for owners of SMEs for them to be able to make well informed decisions that can improve and lead to business growth.

#### **7.3.2 Low Interest Rates Loan**

The government should provide incentives to financial institutions that provide affordable credit for SMEs and start-up businesses as the current interest rates are too high for SMEs and most of them resort to village banking where they can only get very limited amounts of money for their businesses. Further, financial institutions should come up with innovative and less risky ways through which they can provide loans to SMEs with relaxed collateral conditions.

#### **7.3.3 Communication Strategy for Government Support for SMES**

There is need for the government to come up a communication strategy to improve communication of government support and services for SMEs to facilitate formalisation of SMEs for the improvement of individual businesses and the national economy. If government support is not communicated properly, it means only few people will be aware of them and what they need to do to access them much to the disadvantage of majority of SMEs and slow growth of the economy.

#### **7.3.4 Government Policies and Regulations**

The study revealed that there are laws and policies which are meant to support SMEs and facilitate graduation of SMEs from informal to the formal economy. These policies and laws need to be enforced and implemented properly if they are to be beneficial for the SMEs` growth and formalisation.

#### **7.3.5 Cost of Formalisation**

The cost of formalisation in some institutions does not encourage informal SMEs to formalise their businesses. Compliance costs and penalties for non-compliance by some institutions are quite harsh and this has the potential to make business owners to remain undercover in the informal sector.

#### **7.4 Areas of Further Study**

1. The current study focused on *factors that contribute to hindrance of formalisation of Small and Medium Enterprises (SMEs) formalisation regarding Chilenje Market in Lusaka district*. Findings for this study, therefore, cannot be generalised to other parts of the country. Research is thus needed to investigate these factors in other parts of the country to compare the findings.
2. The current study limited formalisation definition to registration of businesses with ZRA and PACRA only. There is need for another study that will on top of ZRA and PACRA include business registration with other institutions like NAPSA and Workers Compensation and compliance to labour laws which also form part of enterprise formalisation.
3. The current study was limited to looking at either SMEs were either formalised or not and did not look at SMEs that were once formalised but slid back into informality. There is therefore needed to look at the experience of SMEs that were once formalised to fully understand the transitioning from informal to the formal economy.

#### **7.5 Study Limitations**

The research was limited to Lusaka urban area in Lusaka district and data was collected from Chilenje market alone. The study findings can therefore not be generalized to other markets in Lusaka district on the account that small sample size leads to decreased power of the test especially when quantitative data is used as was the case for this study which adopted a parallel convergent mixed methods design in which quantitative data was also used. Further, the study may have some biasness which may affect objectivity of its outcome because the randomly selected sample did not come from a well-known sample space which had all SMEs operating from Chilenje market listed.

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# APPENDINCES

## Appendix 1: Informed Consent and Questionnaire

Dear respondent,

The questionnaire presented is purely for academic purposes. It is a requirement for the partial fulfillment for the award of a Master of Science Degree in Innovation Management and Entrepreneurship. Your cooperation will be highly appreciated.

**Tick on all answers that are applicable to you**

### Section A – Demographic Information

- 1 What is your gender
  - a. Male
  - b. Female
2. What age group do you belong to?
  - a. 15 – 19
  - b. 20 – 29
  - c. 30 – 39
  - d. 40 – 49
  - e. 50 – 59
  - f. 60 – 69
  - g. 70 – 79
  - h. 80 - 89
3. What is your level of Educational?
  - a. Masters
  - b. Bachelors
  - c. Diploma
  - d. College Certificate
  - e. Grade 12
  - f. Grade 9
  - g. Grade 7

### Section B – SMEs Operating in the Informal Economy

4. What is the type of your business?
  - a. Hair dressing
  - b. Clothing
  - c. auto shop
  - d. Food
  - e. Hardware
  - f. Groceries
  - g. Liquor shop
  - h. General Dealers

5. Is your enterprise registered with PACRA and ZRA?
  - a. Yes
  - b. No
  
6. If your answer in question 5 is NO, why are isn't your business registered with PACRA and ZRA?
  - a. I don't know the procedure for registration
  - b. It's expensive to register the business
  - c. My business is too small to be paying taxes
  - d. It is time consuming to register the business
  
7. How long have you been in this business?
  - a. Less than 1 year
  - b. 1 – 5 years
  - c. 6 – 10 years
  - d. 11 - 15 years
  - e. 16 - 20 years
  - f. Above 20 years
  
8. Number of full time workers in your enterprise?
  - a. 0
  - b. 1-5
  - c. 5 -10
  - d. 11-15
  - e. 16 - 20
  - f. Above 20
  
9. Do you keep records for your business?
  - a. Yes
  - b. No
  
10. If yes, how do you keep them?
  - a. Manually
  - b. Electronically (computerized)
  - c. Both manually and electronically
  
11. Do you think it is beneficial for you to register your business with PACRA and ZRA?
  - a. Yes
  - b. NO
  
12. If your answer in question 11 is YES, why do think business registration is beneficial to you?
  - a. I can apply for a business loan

- b. I can have training for business
  - c. I can supply goods and services to other companies
  - d. I can collaborate and partner with other companies
13. How much money do you make in sales per year?
- a. Below ZMW 100,000
  - b. ZMW 100,000 – ZMW 200,000
  - c. ZMW 200,000 – ZMW 300,000
  - d. ZMW 300,000 – ZMW 400,000
  - e. ZMW 400,000 – ZMW 500,000
  - f. Above ZMW 500,000
14. How much do you pay for renting your shop per month?
- a. Below ZMW 1,500
  - b. ZMW 1,500 – ZMW 3,000
  - c. ZMW 3,000 – ZMW 4,500
  - d. ZMW 4,500 – ZMW 6,000
  - e. ZMW 6,000 – ZMW 8,000
15. Have you ever gotten a loan for your business?
- a. Yes
  - b. No
16. If your answer in question 15 is YES, where did you get your loan?
- a. Bank
  - b. Micro financial institution
  - c. Loan shark (Kaloba)
  - d. Village banking
  - e. Friends and relatives
17. Do you have any training in business?
- a. Yes
  - b. No
18. Do you think the quality of government services (e.g. condition of the market) you get are worthy paying taxes for?
- a. Yes
  - b. No

**Section C – Formal SMEs Competitive Advantage Over Informal SMEs**

19. Are there SMEs registered with PACRA and ZRA that you personally know?

- a. Yes
- b. No

20. Do you think SMEs registered with PACRA and ZRA have more sales and profits than those that are not registered?

- a. Yes
- b. No
- c. I don't know

21. If your answer in 20 is YES, why do you think SMEs registered with PACRA and ZRA have more sales and profits?

- a. They have more customers
- b. They have more capital
- c. Customers have more confidence in their goods and services

22. Does your business have any partnership with other companies or institutions?

- a. Yes
- b. No

23. If your answer in question 22 is YES, what type of partnership does your business have with other companies or institutions?

- a. Supplying goods/services to another company
- b. Merging with other companies/SMEs to bid for business
- c. Being part of a business association
- d. Other .....

**Section D – Government`s Support of informal SMEs` Transition to the Formal Economy**

24. Are you aware of any support that you can get from the government to support your business?

- a. Yes
- b. No

25. If your answer in question 25 is YES, do you know what you need to do to access the support from government?

- a. Yes
- b. No

26. What type of support do you personally need for your business?

- a. Business training
- b. Business registration with PACRA
- c. Business registration with ZRA

- d. Tax returns
- e. Loan with lower interest rates

27. Do you think the government is doing enough to support SMEs?

- a. The government is doing more than enough
- b. The government is doing well but needs to improve
- c. The government is not doing well

## Appendix 2: Check List for the Key Informants

1. What role do you think SMEs in the informal economy play in the national economy?
2. Do you think it is important for informal enterprise to graduate and operate in the formal economy?
3. What challenges do you think SMEs operating in the informal economy face?
4. What benefits do you think informal SMEs would they get if they transitioned to the formal economy?
5. Why do you think most of the SMEs still operate from the informal economy?
6. How is formalisation beneficial to informal SME owners?
7. Does the cost of formalisation encourage informal SME owners to formalise or to remain informal?
8. To what extent do informal SMEs benefit from government services?
9. Are there any laws that you think support informal SMEs to transition to the formal economy?
10. Do you think the Government is doing enough to support SMEs` transition to the formal economy in Zambia?
11. If no, what do you suggest the Government should do?
12. Do you think informal SME owners are aware of the support they can get from the government to support their businesses?



# THE UNIVERSITY OF ZAMBIA

## DIRECTORATE OF RESEARCH AND GRADUATE STUDIES

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### APPROVAL OF STUDY

**IORG No. 0005376**

**HSSREC IRB No. 00006464**

19<sup>th</sup> August, 2022

**REF NO. HSSREC-2022-JUL-042**

Hastings Chijikwa  
The University of Zambia  
Graduate School of Business  
P.O. Box 32379  
**LUSAKA**

Dear Mr. Chijikwa,

**RE: "INVESTIGATION OF FACTORS WHICH CONTRIBUTE TO HINDRANCE OF SMALL MEDIUM ENTERPRISES (SMEs) FORMALIZATION IN CHILENJE MARKET OF LUSAKA DISTRICT"**

Reference is made to your submission of the protocol captioned above. The HSSREC resolved to approve this study and your participation as Principal Investigator for a period of one year.

REVIEW TYPE	ORDINARY REVIEW	APPROVAL NO. HSSREC-2022-JUL-042
Approval and Expiry Date	Approval Date: 29 <sup>th</sup> July 2022	Expiry Date: 28 <sup>th</sup> July, 2023
Protocol Version and Date	Version - Nil.	28 <sup>th</sup> July, 2023
Information Sheet, Consent Forms and Dates	<input type="checkbox"/> English.	To be provided
Consent form ID and Date	Version - Nil	To be provided
Recruitment Materials	Nil	Nil
Other Study Documents	Questionnaire.	
Number of Participants Approved for Study		

Specific conditions will apply to this approval. As Principal Investigator it is your responsibility to ensure that the contents of this letter are adhered to. If these are not adhered to, the approval may be suspended. Should the study be suspended, study sponsors and other regulatory authorities will be informed.

### **Conditions of Approval**

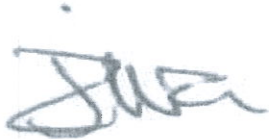
- No participant may be involved in any study procedure prior to the study approval or after the expiration date.
- All unanticipated or Serious Adverse Events (SAEs) must be reported to HSSREC within 5 days.
- All protocol modifications must be approved by HSSREC prior to implementation unless they are intended to reduce risk (but must still be reported for approval). Modifications will include any change of investigator/s or site address.
- All protocol deviations must be reported to HSSREC within 5 working days.
- All recruitment materials must be approved by HSSREC prior to being used.
- Principal investigators are responsible for initiating Continuing Review proceedings. HSSREC will only approve a study for a period of 12 months.
- It is the responsibility of the PI to renew his/her ethics approval through a renewal application to HSSREC.
- Where the PI desires to extend the study after expiry of the study period, documents for study extension must be received by HSSREC at least 30 days before the expiry date. This is for the purpose of facilitating the review process. Documents received within 30 days after expiry will be labelled "late submissions" and will incur a penalty fee of K500.00. No study shall be renewed whose documents are submitted for renewal 30 days after expiry of the certificate.
- Every 6 (six) months a progress report form supplied by The University of Zambia Humanities and Social Sciences Research Ethics Committee as an IRB must be filled in and submitted to us. There is a penalty of K500.00 for failure to submit the report.
- When closing a project, the PI is responsible for notifying, in writing or using the Research Ethics and Management Online (REMO), both HSSREC and the National Health Research Authority (NHRA) when ethics certification is no longer required for a project.
- In order to close an approved study, a Closing Report must be submitted in writing or through the REMO system. A Closing Report should be filed when data collection has ended and the study team will no longer be using human participants or animals or secondary data or have any direct or indirect contact with the research participants or animals for the study.
- Filing a closing report (rather than just letting your approval lapse) is important as it assists HSSREC in efficiently tracking and reporting on projects. Note that some funding agencies and sponsors require a notice of closure from the IRB which had approved the study and can only be generated after the Closing Report has been filed.
- A reprint of this letter shall be done at a fee.

- All protocol modifications must be approved by HSSREC by way of an application for an amendment prior to implementation unless they are intended to reduce risk (but must still be reported for approval). Modifications will include any change of investigator/s or site address or methodology and methods. Many modifications entail minimal risk adjustments to a protocol and/or consent form and can be made on an Expedited basis (via the IRB Chair). Some examples are: format changes, correcting spelling errors, adding key personnel, minor changes to questionnaires, recruiting and changes, and so forth. Other, more substantive changes, especially those that may alter the risk-benefit ratio, may require Full Board review. In all cases, except where noted above regarding subject safety, any changes to any protocol document or procedure must first be approved by HSSREC before they can be implemented.

Should you have any questions regarding anything indicated in this letter, please do not hesitate to get in touch with us at the above indicated address.

On behalf of HSSREC, we would like to wish you all the success as you carry out your study.

Yours faithfully,



*Dr. J. I. Ziwa*

DR. J. I. Ziwa

**ACTING CHAIRPERSON  
THE UNIVERSITY OF ZAMBIA HUMANITIES AND  
SOCIAL SCIENCES RESEARCH ETHICS COMMITTEE - IRB**

cc: Director, Directorate of Research and Graduate Studies  
Assistant Director (Research), Directorate of Research and Graduate Studies  
Assistant Registrar (Research), Directorate of Research and Graduate Studies



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22<sup>nd</sup> August, 2022

**TO WHOM IT MAY CONCERN**

**RE: INTRODUCTORY LETTER FOR HASTINGS CHIJKWA**

This letter serves to introduce Hastings Chijikwa, a bonafide student in our Master of Science (MSc) Entrepreneurship and Innovation Management programme at the University of Zambia – Graduate School of Business (UNZA–GSB). In partial fulfilment of their Postgraduate studies, each student is required to undertake a Dissertation (Research) in the final year of study.

May you kindly assist the student in granting permission for him to collect data from your Institution. The research is purely for academic purposes and the student is ethically bound to treat the provided information with strict confidentiality.

Should you have any queries or would like further information about the student, please contact the UNZA–GSB on the above e-mail address or telephone numbers.

Yours Faithfully,

**Dr Lubinda Haabazoka**  
**DIRECTOR – GRADUATE SCHOOL OF BUSINESS**

cc Associate Director – Graduate School of Business  
Assistant Registrar - Graduate School of Business

