MINISTRY OF TRADE AND INDUSTRY, COOPERATIVES AND MARKETING

WHITE PAPER

ON THE DEVELOPMENT AND PROMOTION OF SMALL BUSINESS

“MAKING LESOTHO A GOOD PLACE TO DO BUSINESS”

November 2002

FINAL DRAFT REPORT

ACRONYMS

AGOA	African Growth and Opportunity Act
BDS	Business Development Services
BEDCO	Basotho Enterprises Development Corporation
CTB	Central Tender Board
GDP	Gross Domestic Product
EU	European Union
GoL	Government of Lesotho
IEMS	Institute for Extramural Studies
I-PRSP	Interim Poverty Reduction Strategy Paper
CBL	Central Bank of Lesotho
LCCI	Lesotho Chamber of Commerce and Industry
LCN	Lesotho Council of NGOs
LHFCD	Lesotho Highlands Fund for Community Development
LMA	Lesotho Manufacturers Association
LNDC	Lesotho National Development Corporation
LRA	Lesotho Revenue Authority
M	Maloti (Lesotho currency)
MDA	Mineworkers Development Agency
MTICM	Ministry of Trade and Industry, Cooperatives and Marketing
NGO	Non-Governmental Organisation
NUL	National University of Lesotho
PAS	Policy Analysis Section
PRSP	Poverty Reduction Strategy Paper
R	Rand (South African currency)
RBP	Regulatory Best Practise
RIA	Regulatory Impact Assessment
RIS	Regulatory Impact Statement
RSA	Republic of South Africa
SA	South Africa/South African
SACU	Southern African Customs Union

SADC	Southern African Development Community
SARS	South African Revenue Service
UNAIDS	Joint United Nations Programme on HIV/AIDS
US	United States (of America)
VAT	Value Added Tax
VCF	Venture Capital Fund
WB	World Bank
WTO	World Trade Organisation

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FOREWORD

In an era of globalization and international market liberalization, governments, including our own, are faced with daunting challenges of developing and strengthening their own indigenous small and medium enterprises. It is in view of the above challenges that the Government of Lesotho has also embarked on developing a policy framework, "White Paper on Development and Promotion of Small Business".

The White Paper attempts to put in place policies that will enable small and medium businesses in Lesotho to fully participate and integrate into the domestic and international market arena, so that they can meaningfully contribute to the country's economic growth. There is ample evidence all over the world to demonstrate that small and medium enterprises employ the majority of the labour force, and hence contribute to employment creation and income generation as well as poverty reduction in any country.

For a long time there has not been any linkages between formal big businesses and the small and medium businesses in our country, it is therefore the intention of Government of Lesotho to work hard to ensure that linkages between big businesses and small ones are established and developed. Such linkages will help to guarantee that our small and medium businesses also enjoy trade privileges afforded to Lesotho by the developed economies such as the US and the EU through AGOA and the ACP-EU Partnership Agreement respectively, as well as by Canada, Japan, Australia, etc.

The main emphasis of this White Paper is on deregulation and private sector development which have been found to be key to small businesses growth and development. This will be a departure from past initiatives whereby government's control and regulation were thought to be important in enhancing economic growth. This belief is based on the historical reality that small business entrepreneurs have been known to be a unique breed of people whose energies have transformed several economies in space and time. The Government of Lesotho believes that if tackled with energy and determination and with support of all stakeholders, the policies on small and medium business development, set out in this White Paper, can make a major contribution to economic growth in Lesotho and thus to the well being of all its people.

Mpho Malie MP

Honourable Minister of Trade and Industry, Cooperatives and Marketing

PREFACE

1. Growth is urgently needed to create employment and alleviate poverty in Lesotho. The Government of Lesotho (GoL) believes that economic growth has to be driven by the private sector. New jobs are only sustainable where they are generated by an expansion in private sector business activity. These are the essential assumptions within which the development of indigenous small business in Lesotho must be located. The GoL recognises that small business is a crucial component of the private sector. In a rapidly changing and internationalised global economy, its adaptability, responsiveness and capacity for innovation make it a key factor in growth and competitiveness.

2. As growth occurs, small business accounts for the bulk of new employment; its contribution as a proportion of Gross Domestic Product (GDP) should also increase. The development process typically follows a common trajectory: From agricultural subsistence to trading and further agricultural development to industrial development. In developed countries, small business has everywhere been crucial to the process which has led to the emergence of large firms with backward linkages to small business in sub-contracting and supply, and forward to the distributive trades (in which small business has again predominated).

3. Thinking on the role of small business has evolved in recent years. Experience has shown that subsidies and direct intervention by governments are of limited effectiveness in promoting private sector development. Governments can and should, however, promote development by removing obstacles to private sector activity – including those resulting from inappropriate legislation, institutional deficiencies and market failures – allowing markets to work with the minimum of interference.

4. The White Paper takes its direction from the Interim Poverty Reduction Strategy Paper (I-PRSP), published in December 2001, and especially the Strategy's commitment to "strong economic growth" as a basis for "sustainable improvements in the poverty situation" (I-PRSP, p.2). It is aligned with the commitment stated by the GoL in the I-PRSP:

> "… to continue the process of market reform and liberalisation, to create an enabling environment for private sector investment and growth and (to) explore the need to provide a more amicable environment for private sector development through the carrying out of appropriate legal and judicial reform programmes".
>
> (I-PRSP, p. 9)

5. This small business development strategy is intended to contribute to economic growth. Although it will have a profound effect on poverty reduction, it is in essence a growth and not a welfare strategy. The GoL's intention is to create an enabling environment within which the private sector in Lesotho can focus its energies on developing itself.

6. The conceptual basis for this paper is that the GoL has a clear view of the respective roles of government and its agencies, the private sector and the non-governmental organisation (NGO) sector. It believes that the core role of government and its agencies is to get the enabling environment right for business, including small business. Equally, it is the role of the private sector (and not government) to provide services to business. The role of NGOs, like government, is to facilitate and monitor the development of the private sector – not to supplant the private sector itself.

7. The strategy here is proposed against a five-year time horizon. It is important to acknowledge that development will not be instantaneous. But if policies are properly implemented the basic building blocks will be in place. That done, Lesotho should be well on its way to having a thriving SME sector at the end of five years.

8. In the rest of this paper:

- Part One gives a situation analysis and describes the background against which the key policy recommendations to promote private sector growth will be proposed. The concept of small business is defined in the Lesotho context.
- Part Two elaborates the actual small business development strategy. It spells out details of an appropriate enabling environment for economic growth in Lesotho including its regulatory, policy, legislative and institutional aspects, and identifies the main hurdles and other issues.
- Part Three lays out the implementation strategy of the GoL. The implementation strategy focuses mostly on actions to be taken in the first year (of the five-year time period). It prioritises actions and recommends structures to manage the process.

PART ONE: SITUATIONAL ANALYSIS

Broad Background

9. A survey of the wider socio-economic context shows why small business development is so important at this moment in Lesotho's history. There are a number of threats to the well being of the Basotho nation. While the development of indigenous small business will not on its own defeat these dangers, it will, through its contribution to sustainable private sector led growth, play a crucial role in alleviating the effects.

10. Lesotho's economy has been overwhelmingly shaped by the power and proximity of the South African economy, especially its mining sector. The migratory labour system has historically operated as a vent for labour supply to the mines and industries of South Africa and, as a result, limited the need for surplus labour to search for domestic jobs and self-employment. A key consequence has been the inhibition of the informal sector in Lesotho which has developed only fairly recently, largely as a result of declining migrant labour remittances from South Africa.

11. With the restructuring of the South African mining sector, starting in the late 1980s, the employment of Basotho miners has fallen by more than half. From a peak of 126, 733 in 1989, total employment on SA mines was estimated (by the Central Bank of Lesotho) to have fallen to 59,000 in the year 2000, a decline of 53%. As a result the contribution of remittances from Basotho mineworkers in South Africa has also fallen dramatically, from 40% of GDP in 1992 to 30% in 2000. There is no doubt that remittances will continue to fall.

12. The economy of Lesotho lacks balance. It is heavily dependent on government expenditure (46% of GDP – a ratio more appropriate for a developed country). But approximately half of government revenue comes from Southern African Customs Union (SACU), a share that is destined to diminish significantly (by 30%) under current agreements. SACU revenue and thus Lesotho's revenue from this source will be reduced further by new special trade agreements negotiated by the Republic of South Africa (RSA) with other countries and trading blocks like the European Union (EU).

13. Currently, the most substantial growth sector in the Lesotho economy is textiles. But the country's "non-cumulation" exemption for the US market under the African Growth and Opportunity Act (AGOA) is scheduled to end in 2004 while AGOA itself expires in 2008. An extension of these deadlines is possible but by no means certain. This, combined with the likely future attractiveness of Mainland China as a location for garment manufacture, suggest a considerable threat to the future of the industry.

14. Another major problem for Lesotho over the next decade will be HIV/AIDS. UNAIDS estimated, in 1999, that 23,57% of the population aged between 15 and 45 were HIV positive. At a macro-economic level, the disease will increasingly impact on productivity, household and business costs, and lost incomes, among other things.

Although it is impossible to quantify the economic impact with any accuracy – if only because of the world-wide move to reduce treatment costs – HIV/AIDS will undoubtedly have a negative impact on economic growth and sustainable livelihoods in Lesotho.

15. The developments described above are putting enormous pressure on Lesotho to diversify its income and industry base. Small business has a crucial role to play in this. Small firms are more flexible than larger enterprises and thus able to respond more effectively to rapid changes in external conditions. These qualities enable them to generate employment and incomes, pioneer niche markets, generate entrepreneurial experience and facilitate the accumulation of small sums of investment capital.

Defining Small Business

16. Although statements about small business in Lesotho must be qualified because available data are limited[1], almost all Basotho-owned enterprises do appear to be located near the smaller end of the enterprise size continuum. The (now outdated) 1990 GEMINI survey found that 79% of indigenous enterprises were single person establishments, 18.5% employed 2-5 people (including the proprietor) and 2.5% employed 6-50 people. Definitions used around the world suggest that where enterprises have fewer than 50 employees, they fall into the small (very occasionally medium) category; there would thus appear to be an almost perfect coincidence between indigenous ownership and "smallness" in Lesotho. The discussion below however shows why it is not useful to simply use the terms "small business" and "indigenous business" interchangeably.

17. It is necessary to define small business in such a way as to take account of the need for economic growth. The problem then is producing a definition that allows the GoL to identify points of leverage where action can facilitate rapid, sustainable growth of small enterprises. For the purposes of the strategy outlined in the next section of this White Paper, the small enterprises likely to contribute most to economic growth are either already formalised enterprises or the (very) small number of potential high growth informal enterprises.

18. Informal enterprises are neither formally registered nor within the GoL's tax net. They are dominated by rural, "survivalist" single-person set-ups and comparative experience indicates that only about 1%, at very most, have real growth potential.[2] Formal enterprises on the other hand are legally registered taxpayers, which positions them better to access finance, justice and services.

19. The conventional categorisation of small business into "micro", "small" and "medium" is crude and somewhat arbitrary. Moreover, Lesotho's poor data on small business renders the quantitative distinctions sought here even more uncertain. As a result, the definition employed here (see box) is simply a rough working definition. It

[1] The most recent proper survey was the 1990 survey by Growth through Microenterprise Investments and Institutions (GEMINI).

[2] Mead, D.C. and Liedholm, C. 1998, "The dynamics of micro and small enterprises in developing countries", World Development 26, p.67

might be appropriate to change it in response to either developments in the economy of Lesotho, improved research and information or both these factors.

Small Business: A Definition for Lesotho

A small business is a firm that is independently-owned and owner managed and has a small (national) market share. Within this description, in Lesotho:

- A micro-enterprise is one that employs fewer than 3 people
- A small enterprise is one that employs 3 to 9 people
- A medium enterprise is one that employs 10 to 49 people

Number of employees has been used as the determining benchmark – rather than firm's turnover or assets – because it allows for easier information gathering and is unaffected by changes in the value of money over time.

20. Behind the matter of definition lies a deeper issue. It is vital that policy-makers see small business as a continuum, from informal micros all the way through to formal medium enterprises. This perspective is far more important than any distinctions made within the continuum. What matters is the ease with which firms are able to move up and down the scale. This applies not only to the relatively well-known example of small, informal enterprises that wish to formalise their operations, but to all sorts of movement, including that of larger small enterprises that might decide to downscale.

Key Constraints on Small Business in Lesotho

21. There are a number of key constraints on small business in Lesotho. These are precisely the factors that will be addressed in the next section of this White Paper (**Part Two: The Strategy**). The list of constraints below is neither comprehensive nor definitive. The emphasis is on the factors about which something can be done by the GoL.

Access to Finance

22. Difficulty in borrowing money or attracting equity investors is a perennial complaint among small business almost everywhere. Generic reasons include inadequate credit records, poor management and project planning capacities, anticipated low returns and the imperative, for banks, that depositors' funds be protected. But in Lesotho there are also a number of country-specific obstacles.

23. Lending is restricted by the limited availability and enforceability of collateral. This factor is directly related to Lesotho's restricted property rights in the case of land, a factor discussed in greater detail later in this section. It also appears that debt can be (and is) easily evaded through legal changes of name and that personal or political relationships have been utilised to delay or prevent actions to realise collateral.

24. Risk management is not well developed in Lesotho's financial sector. The local market is small and until recently (2001) offered low risk-high return investments in government bonds. Moreover, there is little financial competition in the financial sector, a product – at least in part – of very high regulatory hurdles.

Gender Inequality

25. Perhaps two-thirds of small businesses in Lesotho are owned and run by women. However women are minors in the eyes of the law. This deprives women of the legal capacity required to act as independent economic agents. Among other things, women cannot, without the consent of their husband (or male guardian), enter into contracts, sue or be sued, register immovable property in their name, act as a company director or bind themselves as surety.

26. This legal discrimination is one of the factors that tends to trap women entrepreneurs in the informal micro sector. The reform of the law relating to women has hitherto been seen as a social issue although, in fact, it also has profound economic consequences and should be dealt with from that perspective.

Human Capital Development

27. The literacy rate in Lesotho is among the highest in Sub-Saharan Africa. This has however not translated into the supply, on any sort of scale, of the skills needed for private sector development. A recent study of the garment sector observed that almost all managerial and technical jobs are performed by expatriates, that there are virtually no locally-owned larger firms (15 years after the first plant was erected) and that productivity is approximately half that of similar plants in East Asia.[3] Another recent study suggests that the absence of backward linkages between the foreign-owned garment manufacturers and indigenous small business reflects a limited entrepreneurial ethic.[4]

28. It is in no way suggested that there is any deficiency in the inherent capacities of Basotho. Rather, there are a number of fairly obvious reasons for Lesotho's limited human capital development.

29. First, in Lesotho a premium is traditionally placed on academic, not vocational, education. This has resulted in a dearth of vocational training institutions. Foreign investors have not helped matters in that they have conducted virtually no training beyond a very bare minimum needed to perform semi-skilled factory work. Moreover, much of the training done (by BEDCO, the MTICM and the Ministry of Education) appears to be supply driven; there is little evidence that it corresponds to market demand. There is in fact a very considerable divergence between the skills demanded in the economy and those delivered by public sector training programmes.

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[3] Salm et al 2002 Lesotho Garment Industry Subsector Study, DFID, January

[4] Lesotho: Integrated Framework (Diagnostic Trade Integration Study), Sept. 2002, p.90

30. Second, what is often called a lack of entrepreneurialism is, more often than not, a shortfall of information or experience, or the blocking of entrepreneurial opportunity though inappropriate regulation. What cultural bias there might be against entrepreneurialism seems mostly to be gender-related with many men believing that small business is a pastime fit only for women. The origin of this bias probably is in the heavy dependence in the past on (male) migrant labour to South Africa.

High Cost of Doing Business

31. The cost of doing business in Lesotho is raised by the lack of certain domestic sources of supply of materials, the need to visit South Africa to purchase these supplies and the high cost per unit of the small quantities required by SMEs.

32. With regard to developing backward and forward linkages between small and large manufacturers, there is also the added problem that duty free imports of raw materials need to be stored in bonded warehouses. The minimum cost of gaining access to such a facility could amount to as much as 60,000 M, which is of course prohibitive for most small manufacturers. In addition, the few bonded warehouses available are situated at the borders with South Africa, making them inaccessible to rural entrepreneurs.

33. Utilities, including water, electricity and telephone, are very costly and hard to access, even in urban areas. The GoL has moved some distance with its programme of privatising public utility companies. Lesotho Telecom, for example was sold off in 2000 which has led to some improvement in service provision and pricing structure. It is clear that the current lack of access to telephone, water, electricity, and proper roads, are restraining the efficiency and growth potential of the private sector.

Tax and Customs Administration

34. Tax rules favour manufacturing at the expense of the service sector (which includes trading). Tax rates on manufacturing activities are 15% which contrasts sharply with the 35% levied on trading and service enterprises. There does not appear to be a coherent rationale for this disparity. But it does inhibit the development of the services sector and hence employment of Lesotho's abundant semi-skilled workforce. Value Added Tax (VAT), to be introduced in the near future, can also discriminate against small business by increasing transactions costs and damaging cash flows.

35. Importers complain about unnecessary administrative delays and the centralisation of customs administration (in Maseru). Basotho traders frequently fail to reclaim the 14% Value Added Tax (VAT) levied in South Africa due to the systematic complications. In addition to a simple net loss of revenue for these traders, their ability to compete with South African imports is also impaired because South African importers allegedly under-declare the values of imports at Lesotho Customs.

Land Ownership

36. Obtaining title requires costly and complex procedures, with new allocations from communal land being the costliest and most time consuming, especially in the rural areas. As new allocations come from land held in trust by His Majesty, it is probably

appropriate that the Minister has veto powers. However for transfers of already allocated land or sale of subleases, the Minister's general involvement might be regarded as unnecessary red tape. It should ideally be possible to regard these transactions as strictly commercial matters between buyer and seller.

37. The use of land as collateral is complicated in Lesotho and hampers small business access to finance. Despite the various permissions that are required when land is pledged as collateral, it is difficult to recover bad debts. As a result banks will not lend money in the first place, especially in rural areas. Rural property markets are highly illiquid and function poorly, which makes it difficult to sell property. The legal processes involved in recovering collateral are also protracted and costly.

Licensing

38. The business licensing regime in Lesotho is unnecessarily complex and subject to significant delays. The size of the informal sector indicates that the extent of probable non-compliance is significant.

39. There are a number of state agents involved in licensing5 and the signs are that the public has difficulty in identifying the appropriate application points and complying with procedural requirements. Different rules apply to "large" and "small" firms (despite the absence of a legal definition of these terms) as well as to manufacturing and trade licences. All licensing revenue accrues to the Ministry of Finance and Development Planning.

40. The 1999 trade licensing regulations reserve much of the small-scale trading sector for Basotho. But licensing in this area, which should in most instances be straightforward, is excessively complicated. Particularly onerous is the fact that compliance (health, zoning, tenure) is required before the licence application is made. Another feature, the limitation of trading hours, discriminates against the smallest, family-run enterprises. By opening at other times, these businesses could exercise a competitive advantage over larger enterprises.

41. The desire to reserve certain trading areas for Basotho adds another layer of complexity to licensing regulations. This protection does not seem to be very effective: the extent of non-compliance is illustrated by the ease with which foreigners are able to obtain either Lesotho citizenship (which renders them eligible for trading licences) or trading licences through arrangements with Basotho ("fronting"). Officials admit that the prescribed penalties are seldom applied.

42. Licensing regulation is not restricted to business registration. Importing goods or raw materials requires an import license. This is not always straightforward and import licenses are only issued at one point (Maseru).

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[5] Manufacturing licences are issued by the Department of Industry (a substructure of the MTICM). Licences in the tourism industry, including restaurants, bars and bottle stores, are issued by the Ministry of Tourism. The Ministry of Finance reserves the right to issue licences for gambling and breweries. Trading licences are issued by the Department of Trade (another substructure of the MTICM).

Public Procurement

43. The public procurement system discriminates against indigenous small businesses by subjecting them to more stringent proof of regulatory compliance than foreign firms.

44. Slow payment (by the GoL) is common and impacts negatively on the cash flows and hence viability of indigenous small business.

Sectoral Integration

45. There are good reasons for the underdevelopment of small business subcontracts with the larger manufacturers in the garment sector. One problem is the absence of intermediation and natural meeting points. A second problem is the limited capacity of local suppliers. The gap between the large garment producers and most local small businesses, in terms of quality control, reliability, turn around times and access to raw materials and other resources, is huge.

46. The enclave nature of the garment industry is also a problem. The big producers are subsidiaries of foreign firms and have no mandate from head office to pursue local linkages. There are also no reasons, formal (investment code, tax incentives) or informal (supply chain efficiencies) reasons for them to do so. Also, because the major garment plants are in bonded areas, customs requirements are another obstacle to local outsourcing.

PART TWO: THE STRATEGY

Overarching Aim

47. The GoL aims to create an enabling regulatory and institutional environment that will permit indigenous small businesses to increase in number and allow them to strengthen their own capacities and competitiveness. The GoL sees its role as a matter of facilitation with actual growth being driven by private investment and entrepreneurial energies. This does not mean that there is not a role for government in supporting small business development. But the GoL believes that its role in this aspect of the strategy is also mostly concerned with leveraging private sector led small business support mechanisms. The GoL intends to strengthen this market and will refrain from actions that crowd out the private sector.

An Enabling Environment

48. An enabling environment for private sector and especially small business growth requires a reduction of the regulatory, policy and legislative obstacles that currently inhibit the private sector and raise the domestic costs of doing business.6

The Regulatory Environment

49. The GoL will conduct a review of the regulatory environment with the aim of identifying and eliminating the hurdles to private sector development. The GoL will be informed by current regulatory best practise as currently under implementation under donor-funded programmes in a number of other developing countries. A number of the obvious areas for reform are listed immediately below.

<u>The Licensing Regime</u>

50. The licensing regime will be converted, with appropriate safeguards, into a simplified registration system. Inspections and certification will be carried out after, not before, registration. The GoL will set itself a time limit for processing licence applications (15 days is suggested) beyond which the licence is automatically granted.

51. Restrictions on business hours and distance regulations will be eased. The reservation of certain business licences for Basotho has proven ineffective and will be opened up.

52. The licensing regime will cease to operate primarily as a revenue-generating system as experience has shown that such an approach does nothing to reduce red tape. It will be restructured to make it primarily an information gathering system. It should be noted that

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[6] The FIAS study Lesotho: Administrative Barriers to Investment – The Red Tape Analysis, 1997, World Bank provides was an excellent starting point. Its recommendations have however been only partially implemented.

the deepened and widened tax base that will result from a much simplified regulatory system, will, over time, compensate for forfeited licensing revenue.

Taxation and Customs Administration

53. The regulatory review will analyse the ways in which Lesotho's tax regime discriminates against and harms indigenous small business. A second phase, beyond analysis, will be a process, undertaken in collaboration with other key role-players (The Lesotho Revenue Authority and the Ministry of Finance), which will seek to level the playing field in this area. The GoL will establish a Tax Special Task Force as a matter of urgency. In addition to the impact of tax and tax administration on small business, it will explore the possibilities of minimising the compliance cost impact of VAT on small business from the outset of the new system. The anticipated role and structure of Special task Forces is explained in greater detail in paragraphs 89-92.

54. Some areas of customs administration reform can move ahead in advance of the Regulatory Review. These include collaboration between the LRA and the SARS to eliminate fraud and introduce more user-friendly procedures for claiming back South African VAT. Another measure that could easily be implemented would be the introduction of facilities to allow the completion of paperwork for importing, outside of Maseru. Furthermore, to avoid duplication of time-consuming checks (on both sides of the border) harmonisation of Lesotho and South African customs procedures, at all border points, will be explored.

An Enabling Policy Environment

55. The GoL will undertake certain measures to bolster the policy process in support of the enabling environment.

a. In order to understand the nature of and challenges facing small business in Lesotho, a baseline survey will be commissioned. Donor assistance will be sought in this regard. Even in the absence of a more adequate statistical base, there is no reason why the GoL should not immediately seize every opportunity to simplify government administrative procedures and remove overlapping requirements that could harm the growth and prosperity of the private sector.

b. The GoL, through the MTICM, will produce an Annual Report on Small Business. This will be a key document, which will review the progress of small business policy for the past year and lay out a detailed programme of action next, including priorities, targets and timelines. It will be required to report against all recommendations in this White Paper.

An Enabling Legislative Environment

56. The GoL will implement two initiatives in the legislative sphere in order to establish and entrench Regulatory Best Practise (RBP). Some of the principles of RBP are spelled out in the box below. What is key to such an approach is the imperative that the compulsory (i.e. legally-required) transactions costs facing small business be kept to a

minimum. Such costs are made up of a combination of both time – required to comply with regulatory demands (in tax, labour, licensing, approvals, meeting customs requirements, etc) – and pure monetary outlay. The GoL is absolutely convinced that RBP is a fundamental requirement for a successful small business policy.

a. All proposed legislation will undergo regulatory impact assessment. The purpose is to anticipate any adverse effects that proposed legislation might have on small business. The Regulatory Impact Statements (RIS) prepared under this requirement will assess legislation in terms of at least two factors: any significant new compliance costs; and the number of enterprises likely to be affected. In time it will become a legislative requirement that any draft bill tabled in Parliament is accompanied by a RIS.

b. The GoL will introduce a Small Business Act. This will be an expression of commitment to the small business policy laid out in this White Paper. It will also establish a legal basis for the preparation of the Annual Report on Small Business and the preparation of RIS as described immediately above. It will also establish a co-ordinating mechanism within government for small business policy. It will not however detail reforms to the parastatal small business institutional support structure. Such details will be dealt with separately, if necessary under amendments to the founding legislation of the support organisations.

Better Regulation for Lesotho

Definition of Key Terms

What is a *Regulatory Review*?

A comprehensive analysis of all compliance costs that impact on small business in Lesotho. It should cover, inter alia, all aspects of licensing, taxation, customs administration, transfer of land, gender and labour law, as matters of priority.

What is a *Regulatory Impact Assessment* (RIA)?

An analysis of the effects of all proposed new legislation on small business in terms of both new compliance costs and the number of businesses likely to be affected. Any RIA will lead to a ***Regulatory Impact Statement* (RIS)** which will accompany all draft legislation tabled in parliament.

What is *Regulatory Best Practise* (RBP)?

A rigorous pattern of on-going government actions (reviews, legislative reform) to ensure that the compliance costs, or "hassle factor" faced by the private sector are kept to an absolute minimum. The process must become a part of the way in which government conducts its business.

Institutional Support Environment

57. A range of public sector actors conduct activities that make up the most significant part of the small business support environment. At the centre of the GoL's endeavours in this area are the Basotho Enterprise Development Corporation (BEDCO) and the Lesotho National Development Corporation (LNDC). Other significant government actors include field offices of the MTICM, the Lesotho Highlands Fund for Community Development (LHFCD), the Central Bank of Lesotho, (CBL) and the Lesotho Highlands Development Authority. There is also activity on the part of civil society (The Mineworkers Development Agency [MDA], the Lesotho Manufacturers Association [LMA], the Lesotho Chamber of Commerce and Industry [LCCI], and the Lesotho Council of NGOs [LCN]) as well as private sector actors, but in general, small business support from these quarters is poorly developed.

58. The (public sector) institutional support environment has never been comprehensively reviewed although there has been considerable incremental development over time. The LNDC, for instance, has recently completed a restructuring exercise, which has, among other things, seen it accept greater responsibility for indigenous business. BEDCO has acquired a wide range of functions since its establishment in 1980. What is significant is that recently consolidated best practise has never fully informed the institutions in this sphere. The LNDC and BEDCO were both granted their initial mandates in an era where small business support was understood rather differently to the way it is today. It is imperative that the new thinking be applied.

59. The key principles of current thinking on institutional support are explained in the box on the subsequent page. These have a number of implications for the existing institutions.

Current Thinking on Institutional Support

Small Business Development must be market-driven

The private sector is only sustainable if it is competitive. The only way of knowing that a business is competitive is to expose it to the market and in so doing allow its conceptual and managerial adequacy to be tested. The survival of businesses that are not competitive raises the costs for both other firms and consumers.

Government must not crowd out the private sector

Government and its agencies must not be allowed to distort the market through subsidies or protectionism. In particular, they must not be allowed to crowd out profit-driven private sector activity. Even where private companies are not (yet) active, (market-distorting) public sector involvement is a barrier to entry.

The profit motive allows efficient business support

Altruism is not the best possible basis for business support. Market-driven Business Development Services (BDS) – typically professionals offering business services for profit – in a competitive environment is demonstrably better. It allows entrepreneurs choice, eliminates unwanted services and determines sustainable prices.

Government's main role is facilitation

Government should facilitate the emergence of support mechanisms, not actually provide them itself. The latter is the task of the private sector. Government should create and maintain an appropriate regulatory environment, including competition, in order to facilitate the emergence of BDS, including the promotion of management training.

Government should also provide information

A part of government's facilitative role is information provision. This means informing entrepreneurs better about the regulations with which they have to comply as well as about marketing and export opportunities. It may go so far as to organise trade missions.

Government should not provide small business finance

The direct provision of finance by the public sector can at best be only a very limited part of the solution to the small business finance problem. Rather, government should facilitate private sector provision, through appropriate regulatory measures, among other things.

60. The GoL will conduct a comprehensive review of the operations of BEDCO in order to produce a restructuring plan that aligns the organisation with current thinking on institutional support. The review will be required to take account of the wider institutional environment, including the mandates and operations of the MTICM's field offices, indigenous educational institutions and the LNDC in order to ensure there is no unnecessary duplication. In the case of the LNDC a review would simply replicate work recently done and is not recommended. However the GoL will enter a process of consultation with the LNDC around how the organisation can begin a process of exiting the business of founding and running industrial start-up premises.

61. The principles underpinning BEDCO's review are the same as those laid out in the box: Current Thinking on Institutional Support. Without pre-empting the review, the GoL believes it is necessary to point out some of the implications of these principles:

a. The BEDCO review exercise is more than a matter of fine-tuning. It is necessary to revisit the original 1980 founding legislation[7], which lays out BEDCO's mandate and to amend this in order to give the organisation a much sharper focus.

b. In accordance with the old dictum that "form follows function", the BEDCO review is required to begin by laying out the functions the new BEDCO will need to perform if it is to play a role in creating an adequate enabling environment. These must be aligned with the principles highlighted in the box above.

c. BEDCO should not undertake revenue generating manufacturing activities. The organisation will initiate moves towards privatising these sorts of activities. BEDCO must aim to have its establishment costs funded purely by government subvention. Under the principles underpinning this White Paper, the GoL cannot subsidise manufacturing activities.

d. The new BEDCO will focus on informing and helping small business comply with government regulation. It will also provide other information – on VAT refunds and public procurement opportunities, for instance. It will offer a referral service for other sources of assistance.

e. BEDCO's refocusing will position it as a knowledge-based organisation which performs, among other things, a small business advocacy role.

f. The review will produce a strategy allowing BEDCO to exit the small business lending market.

g. BEDCO will find a strategy to exit BDS-type activities as these impede the development of private sector agents in this area. The review will also identify

[7] The Basotho Enterprises Development Corporation Act, No. 9 of 1980

those training activities compatible with the Institutional Support principles above and recommend a process for hiving-off those training functions that are incompatible.

h. The review will suggest a process for privatising industrial premises. There will be consultation with the LNDC, which also faces the need to exit this area. As one of the biggest problems in this regard is land ownership, an immediate transition should not be anticipated. But in the GoL's opinion, market based provision of factory sites is an essential, non-negotiable eventual goal.

Other Aspects of the Strategy

62. Beyond an appropriate enabling and institutional environment, the GoL will continue to pursue (or initiate) reform in a number of areas that affect small business. Some of these reform processes are already well advanced; others will be initiated once this White Paper has been ratified by cabinet. The reform processes described in the box below will have a significant impact on small business. But all of these – and others (see subsequent sections below) – will be complimented by further inputs from the GoL, intended to enhance the enabling environment for private sector growth.

Complementary Reform Processes

The following are some of the more significant initiatives already underway, which have implications for the success of the small business strategy.

Gender Reform:

The Law Reform Commission has written The Married Persons Equality Bill, which will grant men and women equal status in the eyes of the law. The Bill was tabled in 2002.

Land Reform:

The Ramodibedi Commission on land reform reported in 2000. It advocates the wider use of freehold and leasehold ownership.

Public Procurement:

The Central Tender Board is being restructured by a task team based in the Ministry of Finance. It will include private sector representation for the first time.

Customs and Revenue Collection:

The Lesotho Revenue Authority was launched in 2002 with a mandate to reform and improve revenue and customs administration.

Small Business Inputs into Complimentary Reforms

63. The GoL will ensure that:

- Women are granted the legal capacity to act as independent economic agents.
- Unnecessary red tape affecting the registration of land ownership and transfers is to be reviewed and reduced.
- A small business perspective is represented on the Central Tender Board, discrimination against indigenous business is eliminated, government payment periods are improved, the dissemination of information on public tenders is improved and measures are adopted to facilitate small business bidding for tenders.
- The best interests of small business are considered in reforming revenue and customs administration.

Other Important Policy Areas

Finance

64. The GoL will establish a Special Task Force to explore the scope for improving access to finance for small business. Its membership will be broad-based, incorporating relevant Ministries, other government and quasi-government agencies and the private sector, including commercial banks and non-governmental organisations.

65. The mandate of the Special Task Force will be to encourage private sector-led lending to small business. It will review the regulatory and institutional environment for lending, with a view to reducing the hurdles that currently impede the emergence of an adequate lending market. The first duty of the Special Task Force will be to develop an agenda in this respect.

66. The range of factors affecting the private sector's willingness and ability to lend to small business in Lesotho is extremely wide. The agenda of the Special Task Force will thus have to prioritise focus among the following factors, at least: enhancing lending and risk management techniques; the establishment of commercial credit rating agencies; the establishment of an asset mortgage register; how public funds (like the LHFCD and the CB's Venture Capital Fund [VCF]) can be geared for private sector development; reforming (if necessary) the legal and regulatory framework for micro-lending; bank capital requirements; interest rate margins; bad debt provision; collateral requirements and recovery procedures; and the legislation that allows individuals to change their names to evade debts.

Sectoral Development

67. As discussed previously (in paragraphs 45-46), indigenous small business is seldom integrated with larger, mostly foreign-owned enterprises. Although the absence of linkages is most marked in the garment sector, this simply reflects the advanced development of that sector in Lesotho; a similar problem arises in leather and footwear, tourism and agriculture, to name only three of the country's more promising sectors.

68. The GoL, through the MTICM, will analyse the value chains in promising economic sectors, starting with textiles, in order to identify and eliminate blockages and facilitate greater integration. This will be done in partnership with the larger foreign investors in Lesotho. The process is anchored in the PRSP and donor assistance will be sought. A Special Task Force will be established to co-ordinate efforts.

69. There is little point in attempting to link bigger foreign-owned firms with indigenous small business unless there is a clear appetite for linkages on the part of the bigger firms. There may in theory be all manner of opportunities – in the garment sector, in packaging and labels, for instance – but linkages will simply not happen if the managers of the bigger firms are not convinced of their utility.

70. The GoL will thus establish and maintain on-going channels of communication with the bigger foreign investors in Lesotho. The possibility of an investment code, with linkages comprising a key aspect, will be explored. The GoL will also explore possible incentives for firms that actively pursue linkages.

Human Capital Development

71. A comprehensive review of Lesotho's educational system is beyond the scope of this White Paper. However the GoL will consider a number of initiatives.

72. Entrepreneurialism is a complex phenomenon, which, experience indicates, has aspects that cannot be learned in the classroom. But in this context, it is always useful to enhance technical skills as these provide a basis from which the entrepreneur's imagination can proceed. The overwhelming necessity in Lesotho is to ensure that vocational training corresponds with existing and prospective demand for skills. This requires that vocational training programmes and facilities are designed and put into place by industry itself. This is an item for the agenda of the GoL's interaction with the private sector.

73. In the course of this interaction, mechanisms will be sought to encourage foreign-owned firms to engage in training to produce an indigenous middle management and supervisory cadre. As most of these positions are currently filled by expatriates, many of whom do not speak English, a language requirement for the issuing of work permits might be considered. Such a measure may well induce foreign firms to train more extensively and promote local workers. It is important that this is achieved through inducement, after consultation, rather than legislative decree.

74. The GoL will consider ways of utilising the private sector to enhance entrepreneurial or management training. The commercial sector (banks, accountants) might be persuaded to offer workshops or short courses in things like writing business plans, financial planning, basic accounting principles and so on. They should however not be expected to do this out of a sense of charity; for the private sector, it should be a way of unlocking new business.

75. Beyond these measures, the GoL will consider mechanisms for enhancing business education at Lesotho's formal institutions. It will suggest to the National University of

Lesotho (NUL) that a small business centre is established, with a practical focus on business in Lesotho. The Institute for Extramural Studies may be an appropriate location.

Access to Justice

76. Law reform is urgently needed to address problems relating to the administration of justice including issues of accessibility, credibility, simplification, delays and the minority position of women.

77. Consideration is being given to the introduction of a small claims court which is expected to offer more simple and less formal, and therefore less costly, access to justice. The GoL will ensure that any small claims procedure is able to handle claims for and against both natural and juristic persons.

PART THREE: IMPLEMENTATION

Principles

The implementation of the strategy will be guided by a number of basic principles:

Consultation

78. The strategy requires consultation between the public and private sectors at almost every point. The government will rely on regular consultation with the bodies representing the private sector and will seek to identify ways, short of direct financial sponsorship, to strengthen these. In this regard, NGO, trades unions and donors will be included under a wide definition of the term “private sector”.

Why No Small Business Council?

Most countries have formally constituted ‘enterprise councils’ to assist in small business policy development and review. However, these bodies seem rarely to be effective. Collectively, small business has diversified interests, entrepreneurs have little time for any activities outside the day to day operations of their firms and it is extremely difficult to constitute any consultative body with members who can appropriately represent the sector. For these reasons the Small Business Act will not include provisions for a formal consultative council. Instead the Government will rely on regular consultation with the existing business representative bodies and will assist in the strengthening of these. The Government would welcome the independent creation of a Private Sector Forum to act as an umbrella organisation for business representation.

Joined up government

79. MTICM will be the lead (co-ordinating) ministry for the implementation of the strategy. It is obvious that the strategy requires the involvement of a number of other ministries, including inter alia finance, education, development planning, tourism, justice and labour as well as other quasi-governmental stakeholders like the Central Bank, the Law Reform Commission, the Lesotho Revenue Authority, the Privatisation Unit and the LHCDA. Aspects of policy fundamental to the development of small business fall within the ambit of these various actors and, unless all of them are on board, it will not be possible to implement the strategy in a coherent manner.

80. Co-ordinated implementation, however, is only part of the justification for joined-up government. The other main justification is the need to spread an awareness of the role of and challenges facing small business throughout government. Although the MTICM, as lead ministry, will be the primary small business champion in government, if a pro small business ethic does not spread much more widely than this single ministry, the chances of successful implementation are slight.

Lean Institutions

81. The GoL will build on what exists and will avoid creating a proliferation of new programmes and institutions. Before embarking on any new initiatives, the GoL will carefully evaluate what is already in place and decide which elements are to be retained, reformed and created from scratch. This will take due cognisance of the need for the strategy to be private-sector led and the desirability of market-based mechanism.

Implementing Agencies

An Interdepartmental Co-ordinating Committee

82. Primary responsibility for managing and co-ordinating the strategy will be vested in a permanent Interdepartmental Committee on Small Business (hereafter, "the committee"). The committee will set annual goals in pursuance of the small business development strategy. In its first year, it will prioritise the institutionalisation of Regulatory Best Practise (RBP) within the GoL.

83. The committee will consist of the Ministers and/or Permanent Secretaries of the interested departments (as listed in paragraphs 79-80), or their representatives and any other members the GoL should deem necessary. It will have the power to co-opt members, including individuals from outside government, if their expertise is required. The Minister or Permanent Secretary of Trade and Industry, Cooperatives and Marketing will act as chair. Under its mandate as lead ministry, the MTICM will provide secretarial services.

84. The committee shall form Special Task Forces, which will report and make recommendations to it on particular areas of policy. The membership and purpose of these committees is explained in more detail in the section immediately below.

85. Two mechanisms advocated in this White Paper will fall under the authority of the committee:

86. First, the committee will play a key role in facilitating the production of Regulatory Impact Statements (RIS). The primary repository of RIA expertise will be the new Policy Analysis Section (PAS) in the MTICM (see paragraphs 93-97 below). The deployment of this expertise to assist other government departments in preparing RIS in respect of new legislative proposals will be via the committee.

87. Second, the committee will be responsible for the broad mandate of the Annual Report on Small Business. This will be derived from the annual goals set by the committee (see above) but may also include any other (reporting) areas the committee sees fit. The actual report, prepared by the MTICM, will be presented first to the committee and only after it has been approved by that body, to cabinet and then Parliament.

88. The committee will hold its first meeting within two months of Parliament receiving this White Paper.

Special Task Forces

89. Special Task Forces will be established under and reporting to the Interdepartmental Co-ordinating Committee on Small Business. The committee will determine written terms of reference for each Special Task Force, if necessary after consultation. These bodies will report on a small business perspective on particular issues and make recommendations. Where appropriate – as in the case of the issue: Access to Finance – these bodies will include members from the private sector (including NGOs and trades unions) and parastatal organisations.

90. Although it will be up to the committee to designate the appropriate policy areas, the strategy has committed the GoL to establishing Special Task Forces in three areas: Access to Finance; Sectoral Development; and Taxation. Steps will be taken to establish these bodies at the first meeting of the committee, including decisions on terms of reference and membership. Terms of reference will be in accordance with the strategy in this White Paper.

91. Consideration will be given to establishing Special Task Forces on Public Procurement, Gender Equality and Land Reform at the earliest possible date.

92. The establishment of two Special Task Forces is especially urgent as these bodies must respond to processes already underway. One is the Special Task Force on Taxation, which must explore ways to ameliorate the impact of VAT administration on small business. The other is the Special Task Force on Public Procurement, which will be required to provide input into the restructuring of the Public Tender Board. The GoL intends to have these two Special Task Forces up and running within three months of Parliament receiving the White Paper.

Policy Analysis Section

93. The MTICM will create a new Policy Analysis Section (PAS) reporting to the Permanent Secretary. It will be responsible for the initial Regulatory Review. This requires it to identify regulatory impediments to private business activities and make recommendations for reform. The PAS section will also provide assistance to other government departments in the preparation of RIS.

94. The particular expertise required within the PAS suggest that the Section should be involved in drafting the Small Business Act. However it will not be the role of the PAS role to do the actual drafting. The process of drafting the Act will be utilised by the MTICM as an opportunity to disseminate and consolidate the White Paper strategy within its structures.

95. The PAS will have primary responsibility for compiling the Annual Report on Small Business.

96. The PAS will play a key role in value chain analyses, in collaboration with other elements in the MTICM.

97. The PAS will be an integral part of government. However donor support will be sought at the outset to help capacitate the section.

Monitoring and Evaluation

Research

98. A baseline survey of small business in Lesotho will be conducted as soon as practically possible. The work will be commissioned and overseen by the Interdepartmental Co-ordinating Committee. The GoL will seek donor assistance for this project.

Annual Report

99. As envisaged in the proposals for a Small Business Act, the MTICM will produce an Annual Report on small business. The first report, which will be produced by the end of 2003, will chart progress on the most urgent issues and include a detailed programme of action, with target dates, for the implementation of all the plans in this White Paper. Subsequent reports will monitor progress against the targets.

Conclusion

100. This is a time for change. The Government of Lesotho believes that if tackled with energy and determination and with the support of all stakeholders its policies on small business development set out in this White Paper can make a major contribution to economic growth in Lesotho and thus to the well being of its people.