

**FORMALISING THE INFORMAL BUSINESSES IN THE
MIDLANDS PROVINCE OF ZIMBABWE:
OPPORTUNITIES AND CHALLENGES**

Nokuthula Grace Moyo*

Abstract

This paper sought to investigate the challenges faced by businesses found in the informal sector in their bid to formalize their operations. Through the use of purposive sampling data was collected from informal businesses in Gweru, Zimbabwe and analysed through content analysis. The findings from the research indicate that those in the informal sector face a variety of challenges in their quest to formalize their operations. The challenges include the complexity and cost of the registration procedures, the punitive tax rates which are similar for both established businesses and small business start ups. Recommendations were made for policy makers to curb these challenges so that businesses are formalized.

*** Lecturer, Midlands State University, Zimbabwe**

Introduction

Statistics in Zimbabwe indicate that it is a country characterized by a dual economy meaning that there is both the formal and informal economy. A member of parliament stated that the country is suffering from a considerable degree of informality implying that a number of businesses in Zimbabwe are found in the informal sector.

This paper seeks to assess the impediments to Zimbabwe's formalization. The first part examines the literature review on informality and its determinants. The methodology will be discussed followed by a discussion of findings and then policy recommendations will follow.

Literature review

Definition of informal sector

Informal businesses are those that are not registered that operate as underground enterprises and unofficial. They do not contribute to the fiscus and are often referred to as the unofficial economy.

A number of researchers believe that those involved in informal activities perceive that the benefits outweigh the costs. Johnson, Kaufman and Schleifer (1997), assert that the most important are the existence of complex and costly government regulations. Whilst De Paula and Schekman (2006), focus on tax avoidance as the main determinant of informality. Portes and Haller (2005), also contend that the individuals are more likely to operate in the informal sector if the business environment has higher levels of regulation, taxation and corruption.

Johnson et al (1998), indicate that the effectiveness of government officials' discretion in the funding of the regulatory system is a main determinant of the size of the informal economy. Field and Schneider (2010), concur that the design of tax policies and state regulation influences the size of informal activities. Fiscal decentralization has been noted by Buehn et al (2013), as one of the key determinants of informality. Friedman et al (2000) in their research on informality found that the level of informality depends on overregulation and corruption. Whereas Singh et al (2012) asserted that there is a single negative relationship between the rule of law and the size of the informal economy. Schneider and Teobaldeli (2012), studied the political determinants of informality and found that the degree of democracy is negatively associated with the size of the informal economy. In a related study, Buehn and Schneider (2012a), found that corruption and the shadow economy are complements rather than substitutes.

Methodology

Sampling and sample size

The study employed purposive sampling and this involved the hand picking of subjects on the basis of specific characteristics (Black 1999). This method was chosen to ensure selection of adequate number of participants with appropriate characteristics. The research was carried out in Gweru in the Midlands Province of Zimbabwe. A sample size of 100 participants predominantly those in the informal sector and officials from the revenue authority, registrar of companies and local authority were used.

Data collection and analysis

Self administered questionnaires and face to face interviews were used as the primary method of data collection. A pilot test was conducted to ensure the questionnaires' validity and reliability. Data was processed using content analysis in which emerging themes were discussed.

Empirical findings

In studies carried out on doing business in Zimbabwe the following statistics were found:

The Ease of Starting a Business in Zimbabwe

INDICATOR	2012	2013	2014	2015
Rank	145	143	177	180
Procedures	9	9	9	9
Time (days)	90	90	90	90

Source: World Bank

These findings indicate that Zimbabwe needs to introduce reforms in the manner in which businesses are registered. As noted out of 189 countries the country seems to be on a downward trend.

Discussions

Company Registration

There are two forms of registering companies in Zimbabwe. A company can be registered either as a Private Company under the Companies Act or it can be registered as a Private Business Corporation under the Private Business Corporation Act(PBC Act). This PBC was created solely for the small business startups that want to formalize their operations with a minimum of one person up to twenty whereas the Private Company has a minimum of two up to fifty. Both forms of registering begin with a name search but the PBC has more simplified procedures than the

Private Company. The Private Company has its second step being the lodging of the memorandum and articles of association whereas the PBC lodges a statement of Incorporation. There are a variety of forms required by the Private Company but the PBC there is just the Incorporation Statement. The Private Company costs USD150 and the PBC costs USD25.

In order to shorten the process of registering a company shelf companies were created. There are companies that have gone through the whole process of registration and are ready for use. The cost of these are, USD300 for the Private Company and USD 100 for the PBC. The cost of companies is beyond the reach of a majority of Zimbabweans. 80% indicated that they could not afford the process.

There are only two provinces out of ten where the Registrar of Companies offices are found. This makes the registration process inaccessible to the rest of the population. The process has been made complex by the presence of middlemen who act as consultants thus inflating the cost of the company. On the question of awareness of one can formalize their business through registration a number of those interviewed indicated a lack of awareness.

The Ease of Paying Taxes in Zimbabwe

INDICATOR	2012	2013	2014	2015
Rank	127	134	140	143
Payments (no/year)	49	49	49	49
Time (hours/year)	242	242	242	242
Total tax rate	35.6	35.8	35.8	35.8

Source: World Bank

The results indicate that Zimbabwe is at the bottom of the list and it is on a downward trend, showing the need for reforms.

The Zimbabwe Revenue Authority has the mandate of collecting taxes in Zimbabwe. Upon registering the company, the next step is to approach the regional Zimbabwe Revenue Authority to be issued with a registration number known as the BP number.

The Revenue Authority has a one size fits all approach for both the Private Company and the PBC. They pay the same taxes in the form of Corporate Income Tax, Value Added Tax and Pay as You Earn. The different tax return forms are so complex that there is need for the services of an accounting officer who has to enlist the services of a revenue official to assist in the computation.

Tax education is only carried out in the form of weekly press releases. These are not accessible to those in the informal economy as they cannot afford a newspaper. If a registered company fails to comply with paying the taxes required there are punitive measures to deter those who either default or submit late. These penalties accumulate per day.

The revenue authority has also developed a tax head for the informal sector known as Presumptive Tax. This tax is paid on a quarterly basis. Based on their research of the different categories of the informal sector predetermined figures are stipulated for the particular sectors.

Operating Licenses

Local authorities have the mandate to issue out operating licenses for the different businesses that are within the jurisdiction of the local authority. Informal traders who operate flea markets and vegetable vendors have to apply to the local authority in order to be allocated some space in which to trade. They pay a prescribed fee and are given a designated space to trade. The challenges faced by these, is that the sites that are designated to them are usually far away from human traffic. The benefits go to those that operate without these vendors' licenses as they are able to operate in the areas where there is human traffic.

Those who operate shops have to have a shop license which is renewed once a year. There are punitive measures for those shop owners that do not renew their licenses by a given deadline.

Policy recommendations

Decentralization of the Registrar of Companies

The Registrar of Companies need to be decentralized to all the 10 provinces of the country to make it accessible to all. The middlemen who act as consultants should be removed so that the cost of the company is not prohibitive. The cost of registering a company also needs to be reduced so that even a vendor will find it easy to register.

There should be policies which create incentives for those in the informal economy to register such as giving registered companies access to lucrative government contracts and delimiting the provision of certain products and services solely for the small businesses that are registered. Entrepreneurial education should also be provided outlining the pros of business registration.

Introduce a tax friendly environment

The revenue authority needs to be cognizant of the fact that small businesses cannot be treated in the same manner as the established businesses when it comes to tax matters. There is need to introduce a tax structure for the PBC which is different from the Private Company. This structure

should be lower and more user friendly for the small start up. There is also need to remove penalties for non compliance but to create incentives for small start ups to formalize their operations, such as giving them tax holidays in the first year of operations and assisting them get contracts from other taxpaying businesses.

Streamlining Administrative Procedures

There is need to streamline procedures and harmonise all the processes form business registration, taxes and operating licenses into a one stop shop. The number of days for registration can be reduced if all these processes are housed together and other activities take place concurrently.

Conclusion

It is imperative that these policy recommendations be adhered to as Zimbabwe is losing a lot of capital because a lot of businesses are operating informally.

REFERENCES

- Buehn A; Lessman C; and Markwardt G (2013) 'Decentralisation and the shadow economy: Oates Meets Allingham-Sandro.' *Applied Economics* 45. No.18:2567-2578.
- Buehn A; Schneider F (2012a) 'Corruption and the shadow economy: Like Oil and Vinegar, Like Water and Fire?' *International Tax and Public Finance* 19 No. 172-194.
- De Paula A and Scheikman J; (2006) 'The Informal Sector. Levines Bibliograph.' UCLA Department of Economics.
- Estrin S and Mickevicz T (2012) 'Which institutions encourage entrepreneurial growth aspirations.' *Journal of Business Venturing*.
- Feld P and Schneider F (2010) 'Survey of the Shadow Economy and Undeclared Earnings in OECD Countries.' *German Economic Review* 11 no 2: 109-149.
- Friedman E; Johnson S; Kaufman D; (1997) 'The Unofficial Economy in Transition' *Brookings Papers on Economic Activity* 27, 2:159-221.
- Johnson S; Kaufman D; Shleifer and Zoido-Lobaton P (2000) 'Dodging the Grabbing Hand: The determinants of Unofficial Activity in 69 Countries.' *Journal of Public Economics* 76 No3:459-493.

Johnson S; Kaufman D and Zoido-Lobaton P (1998) 'Corruption and the Unofficial Economy.' Unpublished manuscript, World Bank, Washington DC.

Portes A and Haller W (2005) 'The Informal Economy in Neil Smelser and Richard Swedbergs (eds) Handbook of Economic Sociology, New York: Russel Sage Foundation.

Schneider F; Teobaldeli D (2012) 'Beyond the Veil of Ignorance: The Influence of Direct Democracy on the Shadow Economy.' Working Paper no 349 CESifo Group Munich.

Singh A; Jan-Chandra S; Mohamad A (2012) 'Inclusive Growth, Institutions and the Underground Economy.' Working Paper no 12/47 International Monetary Fund, Washington DC.

