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SUMMARY

SMALL AND MEDIUM ENTERPRISE SECTOR IN BURUNDI

REPORT PREPARED FOR USAID

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I. Description of Industrial/Commercial Enterprise Sectors

Formal and informal can be relative concepts in Burundi because not all legally established firms fully comply with the laws; correspondingly, many informal enterprises are registered for tax purposes and can be compelled to comply with other regulations. Secondly, enterprise scale is as much a function of specialization and technical sophistication with a firm as is the amount of its gross assets and the number of permanent employees. Therefore, small, modern, and medium scale enterprises usually have more in common with each other than they do with other enterprises based on their scale of gross assets and permanent employment; the same goes for many other similarly matched firms within each scale of enterprise.

For simplicity, the attached matrix is a synopsis of the definition of each scale of Burundian enterprise (Table 1.), described in greater detail in the following sections.

Industrial development began in the early 1970's, and was dominated by larger parastatals and foreign enterprises. It was not until the 1980's that medium and small scale industries were founded in any number by local investors, particularly in the areas of metallic products, furniture and wood products, and plastic materials.

According to one source, the net increase in the amount of registered companies over the period 1973-1986 was 428, which resulted from 4,149 start ups and 3,728 closures. Although the number of start ups indicates a certain entrepreneurial spirit in Burundi, the amount of closures demonstrates that business people tend to base new activities on inadequate feasibility studies, overrate the market's potential (opening too many enterprises for a particular market, e.g. pharmacies), and underestimate operating expenses.

Approximately 950 small or micro enterprises in the larger provincial towns and Bujumbura have been identified as more established informal enterprises where the proprietor earns most of his income from non farm activity in a fixed location. Nearly 70% of these enterprises are in trade, the remaining 30% of established informal activity being divided among metal and furniture manufacturing, food processing, electrical and mechanical repairs and refabrication, tailoring, and carpentry.

Accurate figures on informal sector employment are difficult to pinpoint because of the dispersion and intermittent nature of much of the activity. However, the Ministry of Labor estimates that approximately 175,000 persons derived their principal source of income from the informal sector in 1986, and around 398,000 individuals earned some income from informal non farm activity in the same year.

Termination is also highly regulated and allows the employee several levels of appeal before termination and access to the Labor Court after termination, even in cases of well certified cause. Consequently, employee termination tends to result in time consuming procedures and costly settlements even when not contested. A firm also has the right to challenge the resignation of an employee. Although not an issue at present, it could become a more critical point as new or growing small and medium enterprises compete for scarce highly skilled technicians and managerial talent.

Table 1 Scales and Characteristics

of Burundian Enterprises

Characteristic	Large Scale Enterprises (LSEs)	Medium Scale Enterprises (MSEs)	Small Scale Enterprises (SSEs)	Micro Enterprises (Micros)
Capitalization:	Gross Assets BFU 75 - 300 million	Gross Assets BFU 15 - 75 million	Gross Assets BFU 3 - 15 million	Gross Assets BFU 50,000 to 3 million
Market:	Upper/Middle income Exports to EEC/Africa	Same as LSEs High entry barriers	Lower/Middle income Medium entry barriers	Local Low to no barriers
Technology:	Modern capital intensive	Modern and Semimodern	Semimodern and traditional	Generally traditional
Employment:	75-200 permanent staff	15-75 permanent staff	3-15 permanent staff	Family members and apprentices
Management:	largest college trained segment	above average skills	limited education/ tech skills	weak; little/no education
Ownership:	GRB controls 72%; foreign 24%; Burundians 4%	approx. 60% Burundians	mostly local rural; some foreign Africans in urban areas	mostly Burundians rural
Location	mostly in Bujumbura	mostly in Bujumbura	Bujumbura and secondary towns	approx. 85% outside of Bujumbura
Financing:	full access to foreign and local banks	access to short and medium-term local financing	self financing/little access to banks	self financing

II. Current Policy Framework and Major Constraints on the Small and Medium Enterprise Sector

Legal Requirements and Costs: All the laws pertaining to incorporation dating from colonial times should be carefully reviewed and modified if necessary, in light of Burundi's need to develop modernized and flexible corporate structures for privatization and the larger capital needs of modern technology. Concurrently, administrative procedures need to be simplified in order to speed up the incorporation process, and fees reviewed in order to allow greater access for new entrepreneurs.

Although access to the formal sector is not perceived as especially difficult by medium scale and modernized small enterprises that are owned and managed by relatively well educated and affluent people, Chapter III will demonstrate that the access fees and institutional barriers are formidable constraints for some traditional small entrepreneurs and micro enterprises. This situation constitutes an important restraint to private initiative because most entrepreneurs abandon their ideas because of overly lengthy formalities. Additionally, the industrial and commercial promoter is subjected to a series of constricting procedures along with substantial expenses.

While these institutional and legal requirements and procedures mount a formidable barrier to micro/informal entrepreneurs who lack the educational skills and financial backing of their more advantaged colleagues, they can also can pose some major constraints to the formal sector as the costs of remaining formal. These costs can be classified as direct costs such as taxes, salaries and benefits and compliance with bureaucratic procedures; correspondingly, there are indirect, non tax costs like the inefficiency of the judicial system in settling disputes or collecting debts and insecurity over property rights as they relate to collateral. Paradoxically, the perceived burden of some of these costs, like transaction taxes for instance, are sometimes the unintended consequences of policies designed to address macro economic issues connected with policy reform.

Taxes: Most of those interviewed underscored the recent broadening and increase in the transaction tax rate from 12 to 15% as the outstanding formal sector policy issue. These businessmen perceive that the Government has not properly thought out the full consequences of these changes because in their opinion the taxes will penalize the consumer through higher prices and a prepayment requirement will seriously deplete businesses' working capital. Additionally, the importers claim to be especially hard pressed because of the lag between the time they receive their merchandise and their ability to identify specific markets and deliver the goods.

The fact that much of Burundi's tax legislation dates from before independence, and that the provisions of the present Code are not readily apparent to the formal sector contributes to some of the misunderstandings. In addition, many businessmen interviewed pointed out that the authorities often use confrontational administrative tactics in tax disputes instead of clarification and dialogue on the tax regulations. The most common complaints were: lengthy audits and open liability for up to three years; and concurrently, too short a time span to rectify or appeal an adverse judgement before the tax authorities can resort to the consignment of bank deposits and receivables, or even the closure of an enterprise.

Another point of disagreement between the Government and the formal private sector is the revision of the Tax Code's deductible business expense provisions. At present, the Code severely limits or disallows travel expenses within Burundi and overseas, marketing expenses, technical fees, pensions and leases.

The Chamber of Commerce is the business community's leading advocate on all of the above points of contention, and maintains an ongoing dialogue with all levels of the Government. On the other hand, the response of some government officials queried on these points was while there is room for further discussion on business deductions that can be verified as necessary and actual business expenses, there is often a need for lengthy audits in order to verify many firm's operations due to poor accounting practices and occasional intentional violations of the tax laws.

The resolution of differences over tax legislation is at the forefront of many countries agendas. It has a certain priority in Burundi, however, because the transaction tax and the limits of current tax legislation are considered by the formal business community to be its most burdensome ongoing cost.

In conclusion,

1. In reviewing the GRB fiscal options, it is not readily apparent that the transaction tax is a heavy burden on every business. However, because of its widespread unpopularity, greater effort should be made to verify its burden on small and less well capitalized enterprises, and make modifications if necessary.
2. Administrative measures should be modified to stress clarification and dialogue in tax collections and disputes, unless an enterprise has a record of non compliance with the law.
3. The Tax Code should be completely reviewed and revised when necessary to allow the Burundian businesses competitive tax advantages extended by rapidly growing economies, such as tax deductions for marketing studies and export related overseas travel.
4. The GRB and the business community at large should promote as a high priority, substantial improvement in accounting standards and financial analysis and auditing procedures.

Labor: The lack of skilled labor has been and will become a more important labor constraint as Burundian industry is increasingly forced to compete in an increasingly competitive market among the developing, and in particular, Southern and Central African nations. However, there have been relatively limited efforts between the GRB and the private sector to coordinate their efforts to define specific skill needs and direct potential employees toward effective job training programs or on the job apprenticeship programs where they can develop the kind of skills that will produce world class products and services.

Wage and benefit legislation should be studied to verify that it is competitive with successful developing nations like Mauritius, and that the quality and cost of labor will attract foreign investment to proposed future projects like a trade zone.

The Ministry of Labor's Department of Manpower (DMO) administrative procedures for hiring employees date from a time when formal enterprise employment was modest and centralized in Bujumbura. As per previous recommendations of USAID and the World Bank, they should be reviewed and eliminated to the largest extent possible since many are not conducive to increased employment.

Legislation should be modified to allow employers to terminate employees with cause without having to pay exorbitant termination pay or incur legal fees in harassment suits.

The GRB and private enterprise need to coordinate their efforts and resources to define specific skill and personnel requirements in light of the Burundi's current and future need for qualified and properly trained workers.

Marketing: Import liberalization substantially, but not completely, reduced import regulatory constraints, and increased the variety of goods and price competitiveness in the markets. However, most government officials, businessmen, and bankers interviewed agreed that with the exception of the well structured distribution networks for industrial materials, petroleum and pharmaceutical products, the wholesale network for durable (including capital equipment) and consumer non durable goods lack specific distribution channels. Thus, supply depends on a series of small middle men between the wholesale outlet and the ultimate vendor that in periods of shortages has opened the market to speculators, but left vendors without dependable supplies of goods.

Several indicators show that many regional commercial and trading centers are currently more active than anticipated on the micro enterprise level, and more attention needs to be given to policies that sustain this activity, at the same time addressing the constraints of larger enterprises which require bigger inventories and sell to larger markets.

Until cargo transport fee deregulation under the Structural Reform Program, cargo transport was highly regulated and the beneficiary of unrealistically high rates. After deregulation, many large agro business and manufacturing firms started their own transport fleets in response to many shipping companies insistence on using the former rates as a base point of reference. Several medium sized and small truck owners were forced out of business because of the new and stronger competition with the result of a decrease in transport available to supply larger quantities of goods to small and medium sized merchants in rural areas.

Transport fee deregulation has to be carried through and the GRB should adopt policies to ensure that free markets prevail in most areas of the economy, meaning any attempts of price collusion are open to criminal action. Correspondingly, special incentives might be formulated to promote the re-entry of small transport operators in to the market.

From an export viewpoint, the Structural Adjustment reforms have pressured local industry into becoming more efficient, however, some of the bias in favor of capital intensive import substitution remains in the form of high rates of tariff protection for parastatals. Positive results from the duty drawback scheme have been limited because of uneven administration of the program's eligibility procedures and excessive delays in exporter reimbursement. Also constraining are cumbersome transit procedures and the inefficiency of the dominant international transporter, OTRABU.

Burundi's four African neighbors, Rwanda, Zaire, Tanzania and Uganda absorb approximately 90% of its manufactured exports, but represent only 12% of its total exports. Rwanda and Eastern Zaire are currently the most important markets because of adequate transport links. These latter two trading partners are also part of the Great Lakes Economic Community (CEPGL) economic and trade union.

Although there have been a number of analyses of Burundi's external and internal export constraints in the past few years, including relatively low product quality by international standards and the lack of export marketing expertise (particularly in small and medium sized enterprises), neither the Government nor any private organization has developed a focused and effective short, medium and long term export policy and progress. This should be done immediately.

Credit: The collateral requirements are a particular problem for SMEs because the legal process is time consuming and difficult (not made any easier by the fact that much rural property is owned by tradition rather than being certified in a communal land registry), and the courts have consistently favored the borrower, even when an obligation has clearly not been honored. To further complicate matters, the revised mortgage law (Code Foncier, 1987) gives the Government unlimited prior claim on any Property as collateral when there is a tax or other dispute between the Government and a bank client. Considering the Government's aggressive stance on tax collection, commercial banks consider this potential prior claim as a virtually complete erosion of their collateral rights. Therefore, with the exception of short term loans, commercial bank credit has been relatively unavailable to SME's with the exception of a handful of well established modern medium and small enterprises.

The general climate for reputable urban formal SMEs has improved in the past few years. However, lending institutions, under pressure to maintain and improve profitability, will still be reluctant to initiate loans or investments in less well established SMEs such as start-ups or small formal rural enterprises without substantial guarantees until they feel more comfortable with the business and legal climate or there are more environmental incentives to lend downmarket such as substantially increased competition, sustained high growth in the SME sector or long term excess liquidity in the banking system.

In conclusion,
1. The Code Foncier should be modified as soon as possible to provide lenders with a more secure collateral position.
2. The GRB should adjust its policies to ensure that both lenders and borrowers are protected under the law. Therefore, all loan disputes should be regularly reviewed by the Ministry of Justice to ensure that the law is equally applied to all parties in a dispute.
3. The amount and term of the National Guarantee Fund insurance facilities should be increased and lengthened and its staff given proper training.

III. Current Policy Framework and Micro Enterprise Constraints

Impediments to Becoming Formal: Acquiring the Carte de Commercant issued by the MCI requires registration at an office of the Ministry of Justice; a minimum BFu 5,000 deposit with CADEBU; opening a tax account; providing a title of business premises ownership or a rental contract; and written permission to operate from the provincial governor. This makes the formal sector relatively unaccessible to a micro entrepreneur who must hire a lawyer for about BFu 50,000 to assist in filling out the forms in largely incomprehensible legalistic French and processing the papers through a bureaucratic maze of several official entities. Consequently, for the entrepreneur whose average initial investment is between BFu 150,000 and BFu 450,000, the barriers posed by the relatively high cost of registration and legal fees; the complexity of handling the registration process with minimal educational skills, social connections and institutional knowledge; the payment of the obligatory savings deposit; and proof of a rental contract or property title, make formalization infeasible.

There is a segment of the micro entrepreneurial population, that would prefer to remain informal, particularly farmers who are part-time traders, in order to avoid the fees and obligations of formality. However, most full micro entrepreneurs who earn the majority of their income from non farm enterprise activity want access to the formal sector because without it they are non entities without rights and access to the legal vehicles that would assist in their continued viability, yet still must pay taxes in the case of established micro enterprises. Therefore, it is clear that most established entrepreneurs want into the formal sector, but simply cannot maneuver through the legal formalities nor sustain the existing costs of being formal.

In conclusion, the commercial permit's registration forms need to be simplified and written in Kirundi. Additionally, the administrative process could be simplified along the following lines:
1. The registration form should only ask basic questions.
2. The entrepreneur should be given the choice of opening a minimum BFu 2,000 account in the CADEBU or the COOPEC.
3. The entrepreneur should be able set wages at market (which is often above the minimum wage) and be responsible for a simplified benefit package that costs no more than 10% of the employees base salary. The Government can induce additional benefits by allowing the entrepreneur to fully deduct the cost of an augmented benefit package;

4. The entrepreneur should be encouraged, but not forced to join the proposed Chamber of Crafts or an enlarged Chamber of Commerce;
5. The entrepreneur should be able to register for the tax office at the same time and place as the business permit. Additionally, he should be given a clearly written or verbal in Kirundi explaining the basis of his tax obligation.

Taxes: Although there is anecdotal evidence that some informal enterprises are able to mitigate their tax burden most persons interviewed in both the informal and formal sectors believed that larger enterprises carried a heavy tax burden. The problem was pinpointing accurate information because of confusion among informal taxpayers on the specific criteria their taxes are based upon. This widespread lack of understanding and the perception that taxes are a heavy burden for more established micro enterprises have acted as a constraint on creating additional employment; upgrading equipment and products; or improving business premises in fear of a tax assessment.

Taxpayers should be given a written and oral definition of their specific tax criteria at the beginning of the fiscal year, and a detailed written explanation and right to appeal when taxes are collected. Additionally, an employee should be available at the commune or the Mayor's office to clarify any questions the taxpayer may have during the fiscal year.

The current tax regulations for micro enterprises should be revised to stimulate the formation of new jobs and working capital formation within the enterprise. Consequently, progressive head taxes on the number of employees should no longer be employed as a tax criteria, and, when possible, tax abatements should be given for funds kept within the business for working capital purposes.

Marketing: The informal sector's principal market is individual households. Nominal sales to formal enterprises are mainly limited to more modern urban micro enterprises who may be sub contracted, and exports are limited mainly to handicrafts or immediate local trading across frontiers with neighboring countries. Concorrently, in the case of artisans, backward linkages are also limited with the exception of more modern urban enterprises (garage and repair subsector, metalwork). Most raw materials are obtained from local stores or from micro vendors in the market place. The implication for micros is limited growth prospects because of a lack of specialization and dependance on narrow low purchase power markets.

The GRB should adopt a concrete overall strategy towards micro enterprises and the informal sector that facilitates and encourages the integration of the informal sector through better access to government and private sector promotional mechanisms and marketing and credit assistance.

Every effort should be made to provide more centralized working space and selling space for artisans and merchants.

A more unified and better focused coordination of micro enterprise policies and programs within the GRB should be a near-term priority.

Credit: Micro entrepreneurs are the least advantaged segment of the population in being able to access credit through formal institutions because of their low and often unpredictable income, and lack of qualified collateral. Aside from these considerations, the micro entrepreneurs' limited educational abilities and training severely constrain their ability to provide adequate financial and operational data, or fully understand loan terms and repayment obligations. Consequently, the formal banking sector does not find lending to micro enterprises profitable and cost effective commensurate with the manpower needed to administer these loans and the perceived high risk.

Fortunately, this constraint has been somewhat alleviated by the spread of the Savings and Credit Cooperative System (COOPEC). The system now numbers approximately 55 branches throughout the country, having 1,000 to 1,500 members each.
However, the COOPECS remain only a partial solution to the micro entrepreneur's financing needs because of the finite number of memberships for micro entrepreneurs within the COOPEC system that plans to limit the number of affiliates to 200 with a maximum of 1,500 members each. Moreover, the COOPECS are not currently recognized by the Central Bank as financial institutions.

In conclusion, the COOPEC should be recognized by the GRB as a bona fide financial system as an important means of extending the Fonds de Guarantie to micro enterprises. Also, to the extent the COOPEC system cannot be expanded, the GRB should encourage the formation of other mutual credit societies.

IV. Micro Enterprise Legislation

The Government's first specific initiative to benefit smaller enterprises was the drafting of the Small and Medium Enterprise Code, Crafts Section.

Chapter 1, Entrepreneurial Enterprises and Artisans: This section states that the purpose of the decree-law is to regulate and protect economic activity defined as artisanal. It proceeds to define artisanal activity as individuals working and selling for their own account based on manual skills, having a capital less or equal to FBu 30 Million, and with 20 or less employees and minimal equipment. Any activity concerned with commerce, leasing, agricultural enterprises, or business offices is excluded.

Chapter 1 could be modified to reflect the GRB pronouncement enunciated by the Minister of Commerce and Industry at the Donor's Roundtable Conference in April 1989 where it was pointed out that the problems of the artisanal and commerce sectors are interrelated, and that they must be reinvigorated to increase the value of Burundi's basic commodities, including agricultural products. In addition, several other recent GRB studies have pointed out that Burundi's economic growth has been hindered by the lack of commercial interchanges between economic sectors.

Focusing on specific clauses, Article 3 might be modified to reflect a more realistic measure of micro enterprise financial assets and labor force; and the definition of a artisan in Article 5 might be broadened to include modernized micro entrepreneurs who employ substantive mechanical as well as manual skills. Article 7 would drop the exclusion of micro commerce and include very small agricultural enterprises involved in both processing and marketing in the draft Code's definition of micro enterprises, but have separate sections dealing with the specific problems of each sector. Additionally, the inclusion of micro business offices might be considered in that they could provide valuable assistance in assisting micro enterprises keep their books, and negotiate with potential lenders such as the COOPEC.

The draft Artisanal Code is a good start, but needs to be modified, taking the above observations and the many others in this section of the report into consideration. Indicators of the other possible modifications to the draft code are:

-- less demanding formalization requirements (Chapter II);
-- a promotion-oriented rather than control-oriented approach to the role of the Chamber of Crafts (Chapter III);
-- providing loan funds through established banking channels rather than inexperienced Ministries (Chapter IV);
-- broader incentives to entrepreneurs and investors, coupled with less restrictive regulatory provisions (Chapter IV).