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**CHANGING REGULATORY
ENVIRONMENT FOR SMALL-
MEDIUM SIZE ENTERPRISES
AND THEIR PERFORMANCE
IN GHANA**

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CHANGING REGULATORY ENVIRONMENT FOR SMALL-MEDIUM SIZE ENTERPRISES AND THEIR PERFORMANCE IN GHANA

Ernest Aryeetey and Ama Asantewah Ahene

INTRODUCTION

The business environment in Ghana has been expected to change quite significantly following the proclamation of a "Golden Age of Business" by the current government soon after its election in 2000. This came after several years of economic reform, which later adopted a slogan declaring the private sector to be "the engine of growth". Indeed considerable interest is shown by policy makers in making all types of private sector activity central to the economic development process. This has culminated in the creation of a Ministry of Private Sector Development and this comes alongside the already existing Ghana Investments Promotion Centre and the National Board for Small Scale Industries. The main purpose of these public agencies is to develop an enhanced environment for the functioning of private enterprises, most of which are SMEs. They are expected to provide the policy framework for the operations of firms and also regulate them in a manner that provides all categories of firms with fair access to the market and public resources. While it is not very clear what the regulatory mandate of these bodies are, beyond the registration of different types of firms, they have some influence on such matters as labour recruitment, minimum wage enforcement, standards in production and locations of industries.

In addition to the public agencies for regulating enterprises, there are a number of bodies that ostensibly seek to bring about self-regulation with a view to improving the operating environment for firms. These include the Association of Ghanaian Industries, Federation of Associations of Ghanaian Exporters, Private Enterprise Foundation, EMPRETEC and Ghana Association of Women Entrepreneurs. The interest of these bodies in improving such matters as access to credit for members, negotiating tax concessions for members, providing training in entrepreneurship, providing information about external markets and maintaining industry standards is quite well known. Self-regulation is basically perceived as an attempt to reduce undue government interference in the operations of businesses.

The study discusses the influence that public regulators and self-regulatory agencies have had on the performance of SMEs in the last decade. It is recognised that the experimentation with different modes of regulation in such areas as taxes, production, standards, labour laws, location of firms and prices will have some impact on the production methods that firms choose. The study also addresses the evolution of regulatory environment in Ghana as well as identifies how the regulatory choices made by firms affect their performance.

The paper is structured as follows: In section 2 we discuss the scope of SME activity in Ghana. This is followed with a presentation in section 3 of the institutional developments and the evolution of regulatory agencies. Here we emphasize the fact that most of the institutional developments have addressed largely the concerns of larger enterprises and these have been usually related to the issues of either attracting investments or promoting the payment of taxes. In section 4 we focus on recent changes in the regulatory environment where considerable self-regulation has emerged to complement state regulation. In section 5, we present findings on how small enterprises have responded to the new institutional developments in terms of organization and performance.

THE SCOPE OF SME ACTIVITY

Small- and medium-size enterprises (SMEs) are generally perceived to be the seedbed for indigenous entrepreneurship and generate all the many small investments, which would otherwise not have taken place. SMEs use mainly local resources and thus have less foreign exchange requirements while adapting easily to customer requirements. Due to their small and perceived flexible nature, SMEs are expected to be able to withstand adverse economic conditions and survive where many large businesses would collapse. SMEs labour intensity lowers capital costs associated with job creation (Anheier and Seibel, 1987; Liedholm and Mead, 1987; Schmitz, 1995). They have often been described as improving the efficiency of domestic markets and making productive use of scarce resources, and thus facilitating long-term economic growth in poor countries.

SMEs in Ghana have been acknowledged to face many obstacles in their development and this is often linked to the absence of a clear vision of the roles in development and the clear lack of a credible policy framework and distinct credible interventions to promote their growth and expansion (Aryeetey et. al., 1994). It may be noted that local entrepreneurship was not seriously promoted in Ghana in the colonial period and in the early 1960s, small-

scale enterprises were seen as political threats. State involvement in import-substituting industries was the approach of the President of the First Republic in his bid to modernise the economy. Due to the heavy importation of raw materials and intermediate goods, the cost of development became high with pressure on the foreign exchange situation, which led to the enactment of the Exchange Control Act in 1961. Import licensing was introduced with quantitative restrictions, high tariffs and administrative restrictions on prices. The Export Promotion Council was established in 1969 to improve exports in the economy including non-traditional goods. This was certainly not an environment that was supportive of small enterprises.

In the 1980s the deterioration in the balance of payments led to a continuous increase in the general price level and the overvaluation of the exchange rate, which led to a reduced capacity utilisation in the import-dependent large-scale manufacturing sector. As the large state sector found it difficult to support the huge labour force it employed, it began to lose some of the labour, which soon found itself in self-employment but at a very low or largely informal level. Indeed, as the economy declined, large-scale manufacturing employment stagnated. According to Steel and Webster (1991), small scale and self-employment grew by 2.9 per cent per annum but their activities accounted for only a third of the value added.

In the 1980s, the deteriorating economic conditions led to the implementation of a Structural Adjustment Programme (SAP) and the Economic Recovery Programme (ERP), which aimed at removing distortions in the market mechanism. Under these programmes, the trade and industrial policies sought to restore incentives for the production of food and industrial raw materials and exporting commodities. Trade controls were removed, and a market mechanism allocated foreign exchange, while price controls were abolished. The decontrolling of interest rates, reduction in tariff and abolishing of import licensing and revision of the investment code were instituted. The base of the tax structure was broadened, subsidies to public enterprises were cut and small-scale manufacturing and services were promoted. But it is important to observe that these trends have not taken away the problems of the SMEs.

It is interesting that while SMEs represent over 95 per cent of enterprises in most OECD countries, and generate over half of private sector employment, the sector employs only about 15.5 per cent of the labour force in Ghana (Parker et. al., 1995). We may emphasize the point, however, that despite this small number of direct employees, the number of

people that depend on SMEs for their livelihoods is considered to be much higher and linked to the informal nature of a number of the transactions of some SMEs. In acknowledging the growth problems that SMEs in Ghana and most parts of Africa face, one may also point out the observation that most SMEs will begin small and eventually die small, without ever having seen any expansion in terms of employment numbers and output.

It is not clear which of the problems that SMEs face are the results of specific public policies and which ones are structural. There is indeed a tendency to attempt to solve all problems with policy measures. It is common to read after surveys are completed that factor availability and rising costs are the most common constraints that SMEs face. Other constraints oft-mentioned are the lack of access to appropriate technology, the existence of inappropriate laws, regulations and rules thus impeding the development of the sector, weak institutional capacity and lack of management skills and training.

It may be noted that the trade liberalisation policies of the 1980s and even later exposed many SMEs to greater external competition than they were used to or could cope with. Aryeetey et. al, 1994 identified this problem in 12.5 per cent of medium-sized enterprises in Ghana. Riedel et. al. (1988) reported that Tailors in Techiman who used to make several pairs of trousers in a month went without any orders with the coming into effect of trade liberalisation. It is again reported in Aryeetey et. al. (1994) that only 1.7 per cent of firms export their output as a result of limited international marketing experience, poor quality control, product standardisation and little access to international partners.

There is indeed a high start-up cost for small firms, including licensing and registration requirements, which impose excessive and unnecessary burdens on SMEs. The cumbersome procedure for registering and commencing business are key issues often cited in surveys. However, Aryeetey et. al. (1994) found that this accounted for less than 1 per cent of their sample. Lall and Pietrobelli (2002) noted that potential investors still spend significant time fulfilling bureaucratic requirements. Other constraints to SME development include the lack of protection for property rights, which in turn limits SMEs' access to foreign technologies. Access to land, utility installation and services, and import procedures remain obstacles to the development of SMEs. The high cost of settling legal claims and excessive delays in court proceedings adversely affect SME operations. Lall and Pietrobelli (2002) find that the response of the investor community to investment promotion has been weak, as evidenced by falling Foreign Direct Investment (FDI) inflows in the late 1990s.

Existing literature realises that changes in the regulatory environment affects various types of firms in different ways. Changes in tax regulation would see larger firms easily adapting than small-medium scale firms. Labour and standard of products regulations of firms might be in favour of larger firms and may actually have negative impact on SMEs. Due to their lack of capacity, SMEs are less likely to deal effectively with problems concerning bureaucratic networks and complexities than larger firms. On the other hand, SMEs are also more likely to adapt to changing bureaucratic conditions by engaging more informal approaches in problem solving. This may have its costs though in generating business expansion.

Despite the relatively large number of institutions that have been created over the years to oversee the development of SMEs, it is not clear what their regulatory roles were intended to be. It was always obvious that the National Board for Small-Scale Industries was expected to promote their development but it was not obvious what the scope of its regulatory role was going to be, particularly since it has never had the means to compel SMEs to behave in any distinct manner. In a sense, the issue of regulating SMEs with a view to creating a level playing field has never been a major policy objective, except when one takes into account the intervention in the 1970s to reserve some classes of small business activity for Ghanaians. In sum, while regulatory systems may promote competition and innovation, which are necessary in promoting industrial competitiveness, job creation and economic growth, the descriptions and operating features of SMEs portray the difficulties that regulators may face in a liberal economic environment, and hence possibly, considerable difficulty in improving or changing the environment for SME development.

INSTITUTIONAL DEVELOPMENTS AND THE EVOLUTION OF REGULATORY AGENCIES FOR SMEs

Recent Initiatives

As indicated earlier, the landscape for the regulation of SMEs is quite confusing. Aside from the difficulty in identifying the regulatory functions of the public agencies in charge of them, it is now even more difficult to tell which public institutions have clear regulatory functions and which ones do not. Against this background, we may note that in 2001, the new President created, for the first time in the country's history, a Ministry for Private Sector Development (MPSD), and appointed a Minister of cabinet rank. The main functions of the new ministry are to translate the vision of a "golden age of business" into realizable sets of actions and to coordinate the various programmes for the development of the sector. In

addition, the new ministry is expected to provide a single point where private sector operators can interface effectively with government. Thus, although not formally stated, it would appear that the primary responsibility for the indigenous private sector and SMEs has now shifted to this new ministry.

There is currently a plethora of papers that seek to guide private sector business initiatives. Policy papers issued by government in support of the sector comprise The Investment Code 1985 (PNDC Law 116), the Export and Import Act, 1995 (Act 503), the draft Integrated Industrial Policy for Increased Competitiveness (MOTI, Nov 2000), the Draft Policy Paper on Micro and Small Enterprise Development (May 2002), the Ghana Poverty Reduction Strategy Paper (2002-2004); and the Policies, Strategies and Action Plan (2002-2004) by the Ministry of Private Sector Development.

In addition to these, a number of "President's Special Initiatives" (PSI) on garments, textiles and cassava starch have been established since 2001. These measures are aimed at boosting the production of these products for export. The PSI on garments and textiles is targeted at the USA market, taking advantage of various protocols offered by the Africa Growth and Opportunities Act (AGOA), while the initiative on cassava starch for industrial use is aimed at EU countries. The PSI is expected to inject over US\$ 3 billion into the economy in export revenue and provide thousands of jobs over the next 5 years.

Older Organizations

While new initiatives are emerging, old roles performed by older organizations have not changed. The Ministry of Trade and Industry (MOTI) still retains the primary responsibility for the indigenous private sector most of which are SMEs. In addition to this, however, various other ministries have responsibility for SME matters, including the Ministry of Finance, the Ministry of Food and Agriculture and the Ministry of Tourism. Other agencies, such as the National Board for Small Scale Industries (NBSSI), Ghana Investment Promotion Centre (GIPC), Ghana Free Zones Board and Ghana Export Promotion Council also implement programmes for the promotion of small business, even if these programmes are severely segmented.

Government continues to expect that, with such an array of actors in the sector, significant progress would be recorded, but this has not been the case. The MOTI has never managed to exercise a strong leadership role, while NBSSI's mandate, combining policy coordination

with implementation and delivery of programmes across the country for SMEs, has always been seen to be too broad, and sometimes even conflicting for an institution with minimum resources. In effect, there is hardly any coordination of efforts or real impact. Furthermore, the MOTI is often generally perceived to be concerned mainly with large-scale businesses. Consequently, SMEs, which comprise the majority of the indigenous private sector, do not particularly align themselves with the ministry or believe that their peculiar needs are taken into consideration in policy matters (Aryeetey et. al., 1994). Although the NBSSI is established purposely to help develop and promote the sector, it is, like most of the ministries, departments and agencies involved, not adequately resourced with funds, logistics and people to be effective. As a government agency, its structure, processes, people and conditions are seen to be anything but entrepreneurial or business-like (Government of Ghana, 2002).

Involving the Private Sector in Policy Development and Outcomes

It is important to acknowledge the fact that major attempts have been made to involve the private sector in the development of policy, but that these initiatives have seen collaboration mainly with the larger operators with little direct benefits to the smaller ones. In 1992, the government, in an attempt to strengthen the response of the private sector to economic reforms undertook a number of measures, including the setting up of the Private Sector Advisory Group. As an outcome, the Manufacturing Industries Act, 1971 (Act 356) was abolished, and this led to the repealing of a number of price control laws. The Investment Code of 1985 (PNDC Law 116), to promote joint ventures between foreign and local investors and a Legislative Instrument on Immigrant Quota, which grants automatic immigrant quota for investors, were also enacted. The Ghana Investment Promotion Centre (GIPC) was established in 1994 to promote and regulate FDI. The government also set up an Investors' Advisory Council in 2001 of 20 business local and international leaders.

In 1995, the Free Zones Act (Act 504) was enacted with the establishment of the Ghana Free Zones Board. The Ghana Free Zones act gives incentives to firms exporting more than 70 per cent of their annual production and the Ghana Free Zones Board (GFZB) promotes the processing and manufacturing of goods. Goods from the Free Zones are exempt from customs duties. Incentives for Free Zone companies include a 10-year tax holiday that is 0 per cent income tax and guaranteed 8 per cent income tax after the tax holiday. Total exemptions from withholding tax from dividends and relief from double taxation for foreign investors/employees are incentive enjoyed within the free zone. Also, no import licensing is

required, 100 per cent foreign ownership is permitted, no restrictions on foreign exchange accounts and repatriation of profits. Most firms operating within the Free Zones benefit from many other incentives and preferential market access, mainly to the EU. The Free Zones Act indeed allows exporting firms Free Zone status, even outside the zone. An UNCTAD (2002) survey found that, while satisfied with Free Zone benefits, investors identified the need for improvement in technology, education, and credit access and tax incentives. UNCTAD (2002) concludes that, "The focus on export incentives seems to have stifled attention to the importance of technology upgrading and human resource development".

In addition to the Free Zones there is the Trade and Gateway Programme. The Ghana Trade and Gateway Programme is inter-sectoral and aims at making Ghana the preferred choice business destination in West Africa. The programme involves advising such agencies as the Customs, Excise and Preventive Service (CEPS), Ghana Immigration Service (GIS), Ghana Civil Aviation Authority (GCAA), Ghana Ports and Harbours Authority (GPHA), Ghana Investment Promotion Council (GIPC), Ghana Free Zone Board (GFZB) and the Environmental Protection Agency (EPA) to offer more courteous, friendly and business-like services devoid of bribery and corruption in order to reduce the cost of doing business in Ghana. The strategy is to attract a mass of export-oriented firms into Ghana to facilitate export-led growth.

The Export Development and Investment Fund

In aid of industrial and export services within the first quarter of 1998, the government proposed the establishment of an Export Development and Investment Fund (EDIF) in 1997, operational under the Exim Guarantee Company Scheme of the Bank of Ghana. The 1998 Budget Statement buttressed the promotion of the industrial sector by stating that, specific attention would be given to the textiles/garments, wood and wood processing, food and food processing and packaging industries for support in accessing the EDIF for rehabilitation and retooling. The government also supports industries with export potential to overcome any supply-based difficulty by accessing EDIF and rationalise the tariff regime in a bid to improve their export competitiveness.

Further Attracting Foreign Direct Investment

In addition to the development of new organizations and programmes, there have been some changes in institutional arrangements intended to make Ghana more attractive. But these do not necessarily target small businesses. For example, visas for all categories of

investors and tourists may now be issued on arrival at the ports of entry while the Customs Excise and Preventive Service at the ports have been made increasingly proactive, operating 7-days a week.

In order to improve the availability of skills for foreign investors, the government now supports programmes aimed at skills training, registration and placement of job-seekers, training and re-training of redeployees. This has resulted in a 5 per cent rise in enrolment in the various training institutes such as The National Vocational and Training Institute (NVTI) and the Opportunities Industrialisation Centres (OIC). As at the end of 1997, 65,830 out of 72,000 redeployed persons who were re-trained under master craftsmen had been provided with tools and had become self-employed.

Legal Instruments, Acts in Support of Business Development

The operations of companies in Ghana are governed by the Companies Code 1963. Provisions under Act 179 allow foreign firms to register a place of business. The general public must be allowed under this Act, to subscribe to the shares of registered foreign firms in Ghana. The Partnership Act 1962 (Act 152) and the Business Name Act, 1962 (Act 151) make provisions for partnership and Business Name (Sole Proprietorship) formation respectively in Ghana.

The Ghana Investment Promotion Centre (GIPC) Act, 1994 (Act 478) provides for international arbitration in disputes and for technology transfer agreements to be legally effective, it must be negotiated with GIPC. Investment in all the sectors of the economy, other than mining, petroleum, free zones and portfolio investments cannot be established without prior approval by GIPC. Mining and petroleum sector projects have to be approved or licensed by the Minerals Commission and the Ministry of Mines and Energy respectively. The Ghana Free Zones Board administers free-zone operations whilst the Ghana Stock Exchange handles portfolio investments. It is required by law for all foreign investors intending to invest in Ghana to register under Act 478 on GIPC.

Ghana's Capital Investment Act 1963, the 1973 Investment Decree and Investment Code already incorporated fiscal incentives for investors. The incentives are tax holidays in the form of 5-10 years by sector, higher for rural banks and agriculture, accelerated depreciation allowances of 5-20 per cent on plant/machinery, by sector, exemptions from import duties

on machinery and equipment, investment allowances and arrangements for profit repatriation.

There are location incentives, which favour small start-up businesses in Ghana. While full taxes are applicable to businesses located in urban areas, those setting up in rural areas and district capitals may enjoy concessions under the Internal Revenue Act 592 (Industrial Concessions). Manufacturing industries located in regional capitals other than Accra and Tema enjoy a 2 per cent rebate, customs duty and income tax exemptions and other inducements. The Commissioner of the IRS has the power to give other incentives to businesses when it is requested and deemed fit. Capital expenditure on R&D was tax deductible.

Taxation and Small Businesses

The fiscal environment has undergone significant changes since the adoption of the Economic Recovery Programme (ERP) and Structural Adjustment Programme (SAP) in the mid-1980s. Changes that have taken place have aimed at expanding and diversifying the tax base, spreading the tax burden in a fairer manner, reducing the cost of doing business by removing distortions in corporate tax and improving the revenue base of government. Administratively, the reforms are meant to make tax administration and compliance less cumbersome, improve record keeping of businesses, and strengthen the system for tax collection and to some extent control smuggling. These changes have also shifted focus from direct to indirect taxes.

The problem for small businesses where taxes are concerned, however, is the extreme variability of these by purpose and their unpredictability. The Local Government Act, 1993 (Act 462) empowers all district assemblies to levy rates, tolls, poll tax and licenses on businesses as well as households. According to a study by NBSSI (2002) on taxation and small-scale business operations, there is hardly any uniformity in the rates applied by districts and the rates are seldom predictable, thus making SMEs extremely insecure. NBSSI reported that the commonest complaints during their study were the perceived notion of overburdening of taxes. UNCTAD concludes that "income tax remittance regulations have an adverse effect on firms' working capital", since payments are made on prior assessments of profits and audits take up to four years, resulting in delayed and reduced refunds".

The government allows businesses to write off additional plant and equipment in two years and carry forward the unutilised capital allowance indefinitely in order to minimise the profit tax on the operations of industrial establishments. The tax compliance cost (costs incurred by businesses in meeting the requirements of the tax structure) is deducted from sales before income is taxed. This includes payments to professional tax advisers, rent, cool and light additional office, postage, telephone and travel to communicate with tax advisers or office as well as time costs. The self-employed are taxed according to the personal income tax schedule, which is also applied to the incomes of employees. Thirty-five per cent of profit is deducted as tax when a self-employed business becomes a limited liability company. A three-year tax holiday is granted to small-scale manufacturers.

The operational fees charged on small-scale industries depend on the type of industrial activity rather than on urban and rural rates. An example cited in the study by NBSSI is the operational fees for mining in the Wassa West District in the Western Region is ₵500,000 whilst the maximum fees for other industrial activities in Sekondi/Takoradi is ₵180,000, which is almost twice as much as Tamale's maximum figure of ₵100,000. The small-scale manufacturers in Ashanti and Western Regions are not charged registration fees but those in Tamale are charged ₵2,000 in addition to the operational fees. Property rates on industrial buildings are 0.75 per cent in Kumasi and 80 per cent in Tamale.

The Income Tax law exempts the first three years commercial income of agricultural processing activity of small-scale firms that operate as registered companies, the first five years residential or commercial rent income from newly completed building, the first five years income of developers of housing estate operating as companies and the interest and discounts on Treasury Bills and savings accounts of sole proprietors. Dividend income on the receipt by the entrepreneur is charged 10 per cent tax. Businesses under the Income Tax Law is obliged to register with the Internal Revenue Service (IRS) office nearest to the place of operation noted on the application form, and has to be renewed annually. Registration has to be done separately for each area of operation up to a maximum of five premises. Filing of income tax returns should be within specific time frames. In addition, entrepreneurs are supposed to deduct tax from employees' salaries each month and pay to IRS by the 15th of the following month, withhold 5 per cent from any payments made out for contract works above ₵200,000 and keep all records on their business transactions for 6 years before disposing of them except IRS has granted permission otherwise.

The CEPS Law enjoins manufacturers to acquire license annually for each operating premise, pay excise duty on all locally manufactured goods consumed in Ghana not later than 21 days after delivery and pay sales tax on all goods manufactured locally. Income returns are to be filled and submitted to CEPS not later than the 10th of each following month of sales.

The income tax law allows the entrepreneur the right to object to and dispute any assessment of tax within 30 days after notification. Likewise the CEPS law gives the entrepreneur the right to appeal against any decision of the commissioner of CEPS within 21 days to the Tax Tribunal.

Sole proprietors and partners enjoy the Social Security Relief, which is granted in respect of contribution to the SSNIT Pension Scheme for the entrepreneurs. The maximum is 17½ per cent of gross business income. There is also the Life Assurance Relief for entrepreneurs with personal Life Insurance Policies in Ghana, which constitute a maximum of 10 per cent of annual gross business income, or the annual sum assured. Basic Personal Relief is granted to all individual taxpayers. Marriage/Responsibility Relief is given to a married man or woman or unmarried person with two or more dependents on application. Children's Education Relief is granted to cover a maximum of three children of the entrepreneur in a recognised first to second cycle schools in Ghana.

There is an assortment of other benefits but little known to many small entrepreneurs. For example, entrepreneurs with aged dependents can claim ₵200,000 each for a maximum of two such old people. The income tax law further makes provision for disabled entrepreneurs for a grant of 25 per cent of his business income. Also, entrepreneurs above 60 years are entitled to relief on application. Losses in any year may be deducted by entrepreneurs against the next five years income, while accelerated depreciation allowance enables entrepreneurs to write-off capital expenditure on plant within two years and five years of building. Excise duty on goods lost or damaged during removal or evaporation is remitted to entrepreneur. Very few SMEs have shown knowledge of these facilities in surveys (NBSSI 2002).

NEW FORMS OF REGULATION AND RESPONSES BY SMEs

In this section, we cover both developments in the reform of taxes and the operations of new public agencies, as well as the development of self-regulation through private sector organizations.

New Trends in Tax Organization

With recent reforms in the revenue mobilization agencies, the main public institutions responsible for tax administration are the Internal Revenue Service (IRS), the VAT Service, and the Customs, Excise and Preventive Services (CEPS). Unlike in the past, the decision to offer rebates and other concessions to investors is no longer the responsibility of the Ghana Investments Promotion Centre and the Minerals Commission; these are the responsibility of parliament. Major tax policy measures implemented over the period include personal income tax relief and the conversion of sales tax into value added tax (VAT). Import taxes have also changed significantly. With a few exceptions, all imports currently attract import duty and import VAT. The import VAT is calculated on the duty-inclusive value of the goods. In addition, excise duty is levied on some imports. A special tax of 10 per cent has been imposed on some previously zero-rated commodities (e.g. human hair, potatoes, fruit and juices, mineral water, paints, cosmetics, clothing, cooking oils etc). There is a zero rating on VAT for pharmaceuticals, thereby ensuring a level playing field between local manufacturers of drugs and importers of drugs.

In 1995, the sales tax was converted into a value added tax (VAT) at a flat rate of 17.5 per cent. This was repealed and the sales tax was re-introduced at 15 per cent. The VAT law was reinstated in 1998 at 10 per cent and adjusted to 12.5 per cent in 2000 (VAT amendment Act 579). The Corporate Tax Law (2000) reduced tax rates from 35 per cent to 30 per cent and withholding tax increased from 5 per cent to 7.5 per cent. The 45 per cent Corporate Tax for Banking and Insurance in 1992 to 2000 changed to 32.5 per cent in 2003. Tax on the hotel industry is 25 per cent and Non-traditional Exports is 8 per cent. Businesses must pay VAT and indirect taxes, such as customs duties. Companies listed on the Ghana Stock Exchange are charged 30 per cent as tax. Manufacturing companies in the Regional Capitals outside Accra/Tema pay a 25.25 per cent tax whilst manufacturing companies outside the Regional Capitals pay 17.5 per cent tax.

The threshold for tax changed from ₵150,000 in 1992 to ₵210,000 in 1994, ₵318,000 in 1995, ₵600,000 in 1996-1998, ₵900,000 in 1998-2000 and ₵1.2 million in 2001. There is no uniformity in the threshold for tax. It is related to the minimum wage, where a certain percentage attracts tax. With respect to VAT, in 1995, the threshold was ₵25 million. In 1998 when it was re-introduced, the threshold was raised to ₵200 million. With the amendment in 2000, the threshold was reduced to ₵100 million. The Internal Revenue Service (IRS) in Ghana has set up collection points near taxpayers in sub districts of the various regional

capitals. In the rural areas, there is field collection of taxes. The IRS introduced the self-assessment system in 2000. Whereas the sales tax was collected only at the manufacturing and importation stages, VAT is collected at all stages of production and distribution. Registered businesses now collect and pay VAT on a self-assessment basis. It is certainly more difficult for SMEs to escape VAT collection and payments.

VAT Services penalties for non-compliance with the law range from various pecuniary fines up to ₺100 million to imprisonment terms of up to five years on conviction and the compounding of offences. As regards enforcement, there are a number of businesses that have been arraigned before the courts and sentenced under the law. In some instances, sentences have included seizure of assets of defaulting businesses. However, most of the defaulters eventually settle out of court. There are no special advantages for small firms in respect of taxes, besides the VAT thresholds.

Regulation of Exports

With the government's current orientation towards diversified exports, particular attention is paid to companies engaging in non-traditional exports (NTEs). Non-traditional exporters are taxed at 8 per cent and are exempt from some export duties. Incentives for exporters include, Export Proceed Retention Scheme, where NTE exporters can retain 35 per cent export earnings in foreign bank accounts for related import purchases and expenses or competitive rates negotiated with the exporter's bankers. The Custom Duty Drawbacks allows manufacturers to draw back to 100 per cent of import duty and other taxes on imported raw materials, where these materials are used in export production. A manufacturer of agricultural products who exports part or all of his production can claim 40-70 per cent tax rebate of his tax liability. This scheme is called the Corporate Tax Rebate. Bonded Warehousing allows manufacturers to seek Custom licence to hold imported raw materials intended for manufacturing export products in secure places without payment or duty. NTEs are exempt from export duties, and discretionary incentives can be negotiated with specific investors.

The Export and Import Act 1995 (Act 503) has eased exporting and importing procedures considerably. For instance, the requirement for full pre-payment of export proceeds before obtaining an approved A2 Form; a major constraint faced by first-time exporters was abolished with the new legislation. The reduction in documentation has led to increased value of Non-Traditional Exports (NTEs) as a result of voluntary declaration of the

commercial value of shipment. Many SMEs and private sector businesses are now engaged in NTEs. Non-traditional exports have grown considerably over the past 10 years due to the Medium Term Plan for Non-Traditional Exports, 1991-1995. This programme jointly implemented by the Ministry of Trade and Industry (MOTI) and Ghana Export Promotion Council, to promote growth in non-traditional exports.

The Trade and Investment Programme (TIP), (1993-1997) was a USAID-sponsored intervention aimed at increasing individual and national export earnings, generating employment and attracting more businesses into the exports sector by influencing official policies and bottlenecks that hinder exports and providing support services to GEPC and MOTI. Through TIP, a new Import and Exports Act was passed in 1995, which liberalized the documentation and procedures relating to export trade. In addition, there have been some other donor-funded programmes. Notable ones over the past 5 years include a private sector development programme funded by IDA, the Capacity Development and Utilization Programme, funded by UNDP, GEDPRO, funded by DFID, and a DFID-supported Challenge Fund.

Investment Code

The promulgation of the Investment Code in 1985 (PNDC Law 116), made it easier for businesses to reduce the cost of and improve compliance with laws and regulations. Some of the measures in the Investment Code are an immigrant quota in respect of an approved number of expatriate employees to be engaged, personal remittance quota for expatriate staff from any tax imposed by any enactment on the transfer of foreign currency out of the country, unconditional transferability through authorized bank in freely convertible currency of dividends/net profits on investment, repayment of foreign loans, fees and charges relating to technology transfer, guarantee protecting private businesses against expropriation by the government, registration of all technology transfer agreements for the purposes of evaluation and advice on the appropriateness of such technology as well as monitoring compliance.

Changes in Labour Regulations

Labour Regulations stipulate that the prescribed minimum remuneration should be paid to any worker or group of workers and records kept. The Industrial Relations Act allows for negotiation between management and workers (or their unions) to determine wages and

benefits. The Workman's Compensation Law also allows and indicates how payments should be made to injured workers.

The insurance laws of the country make it obligatory for employers to contribute 12.5 per cent, and the employee 5 per cent, of an employee's income to the social security fund of Social Security and National Insurance trust (SSNIT). This provides a pension as well as disability benefits for workers, when due.

The labour regulations prescribe that the minimum remuneration may be arrived at through negotiation between government, organized labour and employers. The International Labour Organization (ILO) Convention on Minimum Wage is applied in Ghana. The procedure for employment and firing is indicated in the labour laws as well as in collective bargaining agreements. This is however applied in the formal sector and not in the informal sector. When employees are to be made redundant, the Labour Decree demands that management applies to the Chief Labour Officer before carrying out such exercise. Where employees are unionized, the law requires that the union be involved in the negotiations whereas management must negotiate the terms with affected employees and with non-unionized employees. There is the general perception that small firms find compliance with the labour laws a lot more difficult than larger firms. The period of notice for declaring redundancy depends on the category of affected employee(s). For instance, artisans/labourers are supposed to be given at least two weeks notice. However, where there is a collective agreement with a stipulated period above that of the labour decree, the former should be applied. Also, where the employee has worked for more than 3 years, a minimum of one month's notice should be given.

On compensation, once again, this is supposed to be the subject of negotiation between management and the local union or affected staff. If there is a collective agreement, the conditions as laid down must be followed. Furthermore, the employer must settle any accrued benefits of the employee, when there is no collective agreement. Management and affected staff must negotiate the terms. In cases where an individual feels that they have been treated unfairly, they can take the case to the Commission for Human Rights and Administrative Justice.

Regulations and Standards

The Ghana Standards Board (GSB) was established in 1967 as the institution in charge of standards, metrology, and testing and quality assurance. Its core activities are standards development, testing and certification services are the analysis of food, drugs and industrial raw materials; physical testing of materials, textiles, garments and paper products, calibration services, and training, consumer complaints, public awareness campaigns on labelling rules and good trade practices. Lall and Pietrobelli (2002) detail strong positive achievements by the Board, including acceptance by the EU of GSB testing and health certificates for fish exports and accreditation by the Japanese Government for chemical analysis and certification of food in March 1999. Lall and Pietrobelli (2002) note that GSB has a strong reputation in Africa, and the UN Drugs Control Programme (UNDCP) chose it as a centre for the training of analysis of drugs for the African Anglophone sub-region. The Board has carried out training in ISO 9000, and is near to being certified.

However, Lall et. al. (1994) find widespread lack of appreciation of standards in Ghanaian industry, and note that GSB lacks resources to prepare standards; to encourage industry to use them; and to enforce standards in a meaningful way. Lall and Pietrobelli (2002) find that funding remains a major constraint, with no funding for R&D. Total revenues amount to \$2.2 million (twice Ugandan revenues, but much less than other SSA countries). The government contributes 82 per cent of total revenues. As in other public agencies, salaries form a disproportionate share of the total budget, (77 per cent in 1999). GSB has staff strength of 403, but this is largely administrative staff (250). The wider business community sees the technical and scientific expertise as adequate, with 49 of the professionals holding a masters degree. However, government levels of pay are insufficient to attract good graduates and motivate them to stay.

A codex committee has been set up under the Ghana Standard Board (GSB) to work exclusively on food standards in Ghana, giving clear guidelines on the global food standards to facilitate export. This must be in accordance with the global international food standards being compiled by the UN Agency, the Codex Alimentarius Commission (CAC). Currently, some of the issues raised on global fish industry are that, definition on "fish" must cover only cold blooded and ectodermic aquatic vertebrates excluding amphibians and reptiles while shellfish was defined as aquatic molluscs and crustaceans that are commonly used for food. Brine frozen fish intended for canning should be maintained at a temperature of -9°C

or colder while recycled potable water should be used either chlorinated or treated by other methods.

Phytosanitary regulation stipulates that exporting producers outside the EU must guarantee that the product leaving their countries is in a healthy condition. The phytosanitary certificate, without which the product may not be introduced into the EU, has to be legalised by the food inspection department of the country of origin and the product inspected with respect to insects and diseases. The certificate may not be issued more than 14 days before the date on which the product leaves the country. Some of the products that need the certificate are citrus, pears and mangoes. There is evidence that these standards bother considerably small exporters (Aryeetey and Dogbey, 2000).

The entry-price system is a price regulation set by the EU in 1995 for imported fruit and vegetables. The system replaced the reference price system, which set import duties on fruits and vegetables until 1994. This price system is the minimum price set for imported products. If a product's import price is below the entry-price, a duty is imposed. Products like tomatoes, apples, pears and cucumbers undergo the entry-price system. Thus these products have to conform to the entry price system.

The Bio-terrorism Act, 2002 requires owners, operators, or agents in charge of a domestic or foreign facility that manufactures, processes, packs or holds food for human or animal consumption in the U.S to register with the U.S. Food and Drug Administration (FDA). The law requires that the exporter must have a U.S. agent and registration must include the name of the U.S agent for the facility that would register foreign facility when authorised to do so. Also, prior notice must be given to the U.S. Food and Drug Administration (FDA) before food is imported or offered for import into U.S no later than noon of the day before the day the food arrives at the border crossing at the U.S port of entry. The Ghana Standards Board enforces these regulations in Ghana.

Regulation of Credit Flow

Access to credit has been one of the main bottlenecks to SME development. It is interesting that while the financial sector reforms sought to remove all forms of non-market allocations of credit, there have been a number of interventions in the last decade that have sought to ensure that distinct groups of businesses have obtained credit. The only difference between

these and earlier versions of directed credit has been that they have attempted to ensure that interest rates are not too different from market rates.

The initiatives have included the Business Assistance Fund (BAF) in 1994 and the Rural Finance Project in 1995 to provide both short and long term finance for small-scale businesses. The Export Development and Investment Fund (EDIF) was set up in 1997 but became operational in July 2001. It provides funding for exporters and their sub-contractors. There is the general perception that since the implementation of this is only just beginning, it might be too early to assess its impact on access to credit. There is also the Private Enterprise and Export Development Project (PEED), a joint Ghana Government/World Bank Project to address the financial constraints of the non-traditional export sector through a credit of US\$41million. The project granted loans of up to ₵50million to small and micro enterprises in the manufacturing and service sectors, including returnees from abroad seeking to establish new enterprises from the Promotion of Small and Micro Enterprise Fund (PSME). This is a joint Government of Ghana/German Government facility. The Fund for Small and Medium Enterprise Development (FUSMED), in the early 1990s supported by IDA financed SMEs to increase employment, output and incomes. In 1989, the Programme of Actions to Mitigate the Social Costs of Adjustment (PAMSCAD) had funds to assist SMEs.

THE REGULATORY ENVIRONMENT AND FIRMS' PERFORMANCE

This section presents the findings of the survey conducted in two metropolitan areas in Ghana, Accra and Tema. The study involved 200 SMEs (firms with less than 30 employees) using a structured questionnaire to interview entrepreneurs/owners of these firms. The firms were randomly selected using a listing of small and medium firms from the National Board for Small Scale Industries (NBSSI), the Association of Ghana Industries (AGI), and the Registrar General's Office. As could be expected, some of the names and locations in these lists are outdated giving misleading directions so other firms had to be replaced with what was originally selected. Firms involved in economic sectors such as wood processing, food processing, garments/textiles, services and manufacturing were chosen for the survey. However, the number of firms chosen in each sector was not equal. Questions concerning the operations of the firms as well as the compliance of the various regulations in the country were asked. The regulations considered were the licensing, investment code, location, registration/reporting, labour, standards and support services. Some of the information gathered includes the ownership structure, the characteristics of the firm and entrepreneur and the operations of the firm.

Business History

The survey findings indicate that of the 200 firms interviewed, 12 firms were established between 1950 and 1970, 39 firms between 1971 and 1990 and 144 firms between 1991 and 2004. The phenomenal growth in SMEs between the 90s and early 2000s is no surprise, as the economic reforms had taken significant hold then with its associated benefits and side effects. For the purposes of the study, we undertook another period division to observe the growth of SMEs between 1993 and 2002, and after 2003; to learn what had happened in the intervening decade. The outcome is strikingly similar to the earlier conclusions; many firms started in the 1993 – 2002 period than the entire period preceding that decade. The evidence after 2002 also suggests a trend similar to that witnessed in the preceding decade. Figure 1 depicts trends in SMEs over these periods discussed.

Figure 1: Number of Firms by Output Classification, Start-Up Capital, and Year of Commencement of Business

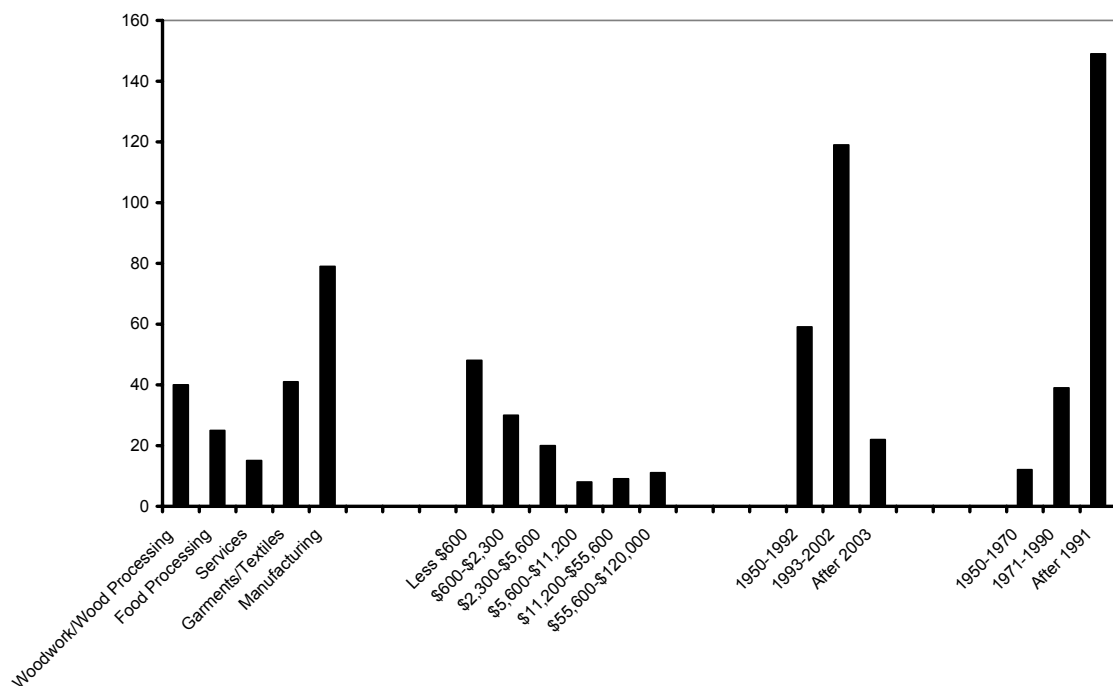


Figure 1 again depicts the pattern of firms' start-up capital. With regard to the amount of capital firms began with, over 45 out of the sample started with a capital of less than \$600¹. Indeed, not all firms provided answers to the question of start-up capital. Notwithstanding this shortcoming, firms that commenced business with a capital of less than \$5,600 constituted over 70 per cent.

An examination of the 200 firms by firm size reveals that 80 of them had employment strength of 1 to 5 employees when they commenced business; however it declined to 14 for firms that started in 1993, though the decline had apparently reversed by 2003. Significantly, majority of the firms in all three-period categorisations were employing between 1 – 15 persons. Firms employing between 16 – 30 persons were rather small; both for those considered at start-up and for the year 2003. Clearly, firms within the manufacturing sector constituted the largest share compared to the other sectors based on firm size classification. This pattern is presented in Table 1 and in Figure 1. The second relatively large sector is Wood Processing, followed by those engaged in Food Processing, then by those engaged in Garments/Textiles. In Ghana most of manufacturing firms are located in Accra-Tema Metropolis while most of the wood processing firms are located near their source of raw material, which is the forest zone. This explains the dominance in the sample of firms engaged in manufacturing activity.

Firm Characteristics

There were more male owners of firms than were females. Thus, while the population structure of Ghana indicates that there are more females relative to males, in enterprising field, the males dominate. Generally in Ghana, women are relatively more risk averse than their male counterparts. While the males take the risk to enter into businesses with long gestation periods, women are more often seen in the buying and selling and other businesses with shorter gestation periods. This is largely a cultural phenomenon where women are expected to use their income on the upkeep of the home. This cultural demand means that generally most women cannot afford to establish enterprises with long-term returns.

Firms that are classified as sole-proprietorship constituted about 58 per cent whilst limited liability enterprises as well as partnership constituted about 35 per cent and 7.5 per cent respectively of all firms sampled. About 60 per cent of the firms interviewed have less than or about 6 paid employees. Interestingly there are more firms with limited liability status than partnerships. About 71 per cent of the sampled firms are in fact small enterprises, that is, firms with less than 10 employees. Owners of the firms are not so eager to increase employees due to lack of funds to expand their businesses and to the limited scope of the market. Manufacturers of wood and carvings complained about dwindling size of the export market for their products resulting largely from the September 11 disaster in the USA which is their main export destination.

Other firm characteristics, especially on age of firm owners and their educational attainment against the size of firms are presented in Table 2. The study shows that majority (about 48 per cent) of firm owners fall within 30 – 39 and 40 – 49 age categories. These are the economically active population group which goes to say that, SMEs are not the dumping place of retirees in Ghana but adventurous young entrepreneurs with the desire to develop their own businesses and see it grow. This age group also think there is less flexibility to apply what one has learnt in the formal sector besides the difficulty in getting job placement. Again those with a minimum of secondary education are in the majority (65 per cent). This obviously indicates that the owners of SMEs are considerably literate, with the obvious implication of better management and performance of their enterprises.

Table 1: Firm Size according to Economic Activity Output Classification

	Wood Processing	Food Processing	Services	Garments/ Textiles	Manufacturing	Total
Firm Size						
Period: Start-Up						
Own Account*	1	---	---	---	1	2
1 – 5	18	10	5	14	33	80
6 – 10	1	4	5	---	15	25
11 – 15	---	1	1	---	5	7
16 – 20	1	---	1	---	3	5
21 – 25	---	---	---	---	1	1
26 – 30	1	2	---	---	7	10
Period: 1993						
Own Account	---	---	---	---	---	---
1 – 5	4	2	---	5	3	14
6 – 10	---	2	---	---	3	5
11 – 15	2	---	1	---	1	4
16 – 20	---	---	2	---	---	2
21 – 25	---	---	---	---	---	---
26 – 30	2	---	1	1	6	10
Period: 2003						
Own Account	---	---	---	---	---	---
1 – 5	16	6	1	18	17	58
6 – 10	7	4	2	5	15	33
11 – 15	3	---	2	2	4	11
16 – 20	1	1	1	---	2	5
21 – 25	1	---	1	---	1	3
26 – 30	2	2	3	1	19	27

Source: Survey Data * Own account refers to one-man business

**Table 2: Characteristics of Firms
Firm Size Classification**

	1 – 5	6 – 10	11 – 15	16 – 20	21 – 25	26 – 30	Total
Gender							
Male	74	32	10	4	6	26	152
Female	34	7	1	2	1	3	48
Legal Status							
Sole Proprietorship	70	30	6	4	---	5	115
Partnership	10	3	1	---	---	1	15
Limited Liability	22	7	4	5	6	26	70
Age of Owners*							
20 – 29	14	2	---	---	1	---	17
30 – 39	39	7	1	---	1	1	49
40 – 49	13	13	3	3	2	12	46
50 – 59	7	7	3	1	1	5	24
60 +	9	2	1	1	1	4	18
Education							
None	19	2	5	1	1	4	56
Primary	---	1	---	---	---	1	2
Middle School	7	2	1	---	---	1	11
Secondary	21	7	2	2	---	5	37
Vocational/Technical	25	14	---	1	1	3	44
Tertiary	19	9	3	2	4	13	50

*Some respondents were unwilling to disclose their ages.

Source: Survey Data

Whilst the start-up capital for SMEs range from less than \$600 to about \$120,000, the sources from which these start-up capital are raised varied considerably (Table 3). Some firms had more than one source of start-up capital. In spite of the varied sources that were available to firms, the main sources of capital were from Own Savings and from Borrowing from Friends and Relatives. It is however not surprising to note that only 1.5 per cent of the firms interviewed got their start-up capital from a local bank. It is one of the main constraints SMEs face in establishing their firms and mostly the first issue commented about in the survey. Their concerns are that the banks are not friendly to the SMEs and that government should intervene on their behalf.

About 29 per cent of the entrepreneurs were salaried workers in their previous occupation, 25 per cent established their businesses right from school, and 18 per cent had been apprentices in similar industries. This is depicted in Table 4. Being an apprentice for about three years before owning one's own enterprise is the norm for firms in the wood processing and some garments/textiles sectors. Half of the entrepreneurs had received no training at all either from the government, NGO, local or foreign firm. Very few of the firms interviewed export their products. These firms constitute 18 per cent of the total firms surveyed and found mainly in the Garments/Textiles sector. Firms in the wood processing sector gave the September 11 disaster as the cause of their falling exports.

**Table 3: Sources of Start-Up Capital for Firms
Output Classification**

	Wood Processing	Food Processing	Services	Garments/ Textiles	Manufacturing	Total
Start-Up Capital						
Less \$600	18	6	2	15	7	48
\$600-\$2,300	7	4	2	9	8	30
\$2,300-\$5,600	4	2	1	1	12	20
\$5,600-\$11,200	---	---	1	2	5	8
\$11,200-\$55,600	---	---	1	2	6	9
\$55,600-\$120,000	---	---	1	---	10	11
Sources of Capital*						
Own Savings	33	21	12	36	64	166
Borrowing from Friends/Relatives	8	---	2	10	12	32
Loan from Foreign/ Donor Agency	---	---	---	---	4	4
Loan from Local Bank	---	1	---	---	2	3
Loan from Money Lender	---	---	---	1	---	1
Loan from Supplier	1	---	---	1	1	3

* Multiple responses

Source: Survey Data

Table 4: Previous Occupation according to age of Firm Owners
Age of Respondents (Firm Owners)

	20 – 29	30 – 39	40 – 49	50 – 59	60 +	Total
Previous Occupation						
Unemployed	1	5	2	---	1	9
Salaried Worker	1	14	23	11	9	58
Worked with another SME	4	7	6	4	---	21
Operated another Business	1	3	9	4	4	21
Studying*	13	23	6	6	2	50
Apprentice	10	25	1	---	1	37
Barrister-at-Law	---	---	1	---	---	1
Farmer	---	---	---	---	1	1
Trader	---	1	---	---	1	2

Source: Survey Data