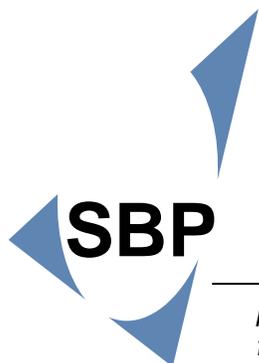




# **The State of Small Enterprise in Lesotho**

**A study undertaken by SBP  
for the  
Ministry of Trade and Industry, Cooperatives and  
Marketing**

OCTOBER 2008



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*promoting strategic partnerships  
for business growth in Africa*

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## 2. Glossary

|             |                                                                             |
|-------------|-----------------------------------------------------------------------------|
| BDS         | Business Development Services                                               |
| BEDCO       | Basotho Enterprises Development Corporation                                 |
| BOS         | Bureau of Statistics                                                        |
| CBD         | Central Business District                                                   |
| EA          | Enumerator Area                                                             |
| GDP         | Gross Domestic Product                                                      |
| GEM         | Global Entrepreneurship Monitor                                             |
| GoL         | Government of Lesotho                                                       |
| ICA         | Investment Climate Assessment                                               |
| ICT         | Information & communications technology                                     |
| IFAD        | International Fund for Agriculture Development                              |
| ILO         | International Labour Organization                                           |
| IMF         | International Monetary Fund                                                 |
| IPRGS       | Interim Poverty Reduction and Growth Strategy                               |
| LCCI        | Lesotho Chamber of Commerce and Industry                                    |
| LNDC        | Lesotho National Development Corporation                                    |
| LRA         | Lesotho Revenue Authority                                                   |
| M           | Maloti (Lesotho currency)                                                   |
| MCA         | Millennium Challenge Account                                                |
| MCC         | Millennium Challenge Compact                                                |
| MHAPS       | Ministry of Home Affairs and Public Safety                                  |
| MOF         | Ministry of Finance and Development Planning                                |
| MTEC        | Ministry of Tourism, Environment and Culture                                |
| MTICM       | Ministry of Trade and Industry, Cooperatives and Marketing                  |
| NGO         | Non Governmental Organisations                                              |
| OSS         | One Stop Shop                                                               |
| PCGF        | Partial Credit Guarantee Facility, LNDC                                     |
| PPAD        | Public Procurement Advice Division, Ministry of Finance                     |
| PSCEDP      | Private Sector Competitiveness and Economic Diversification Project         |
| PSCI        | Private Sector Competition Initiative, MTICM                                |
| PSD         | Private Sector Development                                                  |
| PSP         | Priority Support Programme                                                  |
| SACU        | Southern African Customs Union                                              |
| SADC        | Southern African Development Community                                      |
| SARS        | South African Revenue Service                                               |
| SMEs        | Small and medium enterprises                                                |
| TVET        | Technical and Vocational Educational Training                               |
| VAT         | Value Added Tax                                                             |
| White Paper | MTICM <i>White Paper on the development and promotion of small business</i> |

### **3. Acknowledgements**

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Finally, we record our sincere gratitude to Mr Daniel Ticehurst and the other members of the PSP team, who provided invaluable support, insights and contacts throughout the project.

## 4. Summary and principal action points

The primary objective of the *State of Small Enterprise* project is to provide information to inform the Government of Lesotho's programmes for SME support. This requires information on the distribution and activities of small and medium enterprises (SMEs) and the characteristics of business owners, as well as an exploration of the challenges and opportunities faced by small enterprises in terms of access to finance, access to markets and potential business linkages, issues relating to infrastructure, technology and regulation, and awareness and use of business support services.

The project report presents the findings of a survey of just over 600 SMEs across Lesotho, and analyses the key challenges and opportunities facing SME development in the country based on the survey results and recent policy initiatives and programmes.<sup>1</sup>

### 4.1.1 Profile of small businesses

The large majority of SMEs are **survivalists**, and may have limited potential for growth and expansion. There is a huge pre-dominance of micro-enterprises in the economy. The survey deliberately did not replicate this proportion of micro-enterprises in the sample, in order to obtain robust data on businesses with a greater potential for growth.

One third of businesses covered by the survey were operated solely by the business owner with **no employees**, and just over a third employed only one person in addition to the business owner. Eighty percent of businesses reported **annual turnover** of below M200 000, and less than four percent reported turnover above M1 million.

The majority of SMEs were **retailers**, followed by businesses in the service sector, and much smaller numbers in the industry and agro-processing sectors. Businesses in the tourism, professions and financial services sectors constituted even smaller proportions of the sample. SMEs in the tourism sector in general reported a higher turnover than other businesses surveyed, and were also more likely to have experienced growth in the past few years.

The largest SMEs in the sample were for the most part **owned by men**. Women were far more likely to own survivalist enterprises.

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<sup>1</sup> The project did not undertake a census of small business activity across Lesotho, nor did it attempt to estimate the total number of small enterprises (formal and informal), for methodological reasons that are discussed in the main report. The project does however provide a robust and informative in-depth picture of business activities, together with the characteristics of enterprises and business owners in a range of areas, representing a cross-section of the country.

Only 14 percent of people under 30 years old owned businesses – suggesting a significant gap in opportunities and incentives for **young people** to become entrepreneurs.

Just over half the businesses in the sample reported that they were **registered with the LRA**. Among medium-sized SMEs (10 to 49 employees) the figure for tax registration was 90 percent. Only ten percent of surveyed SMEs were registered as **companies**.

Almost half the businesses surveyed had been in operation for **less than 4 years**, although a quarter were in operation for ten years or more.

Less than 40 percent of businesses said that their **turnover had increased** in the past three years, and only 14 percent had increased their **employee numbers**.

The vast majority of surveyed businesses provided goods or services only to the **domestic market** and generally only within the local area. Only three percent provided goods or services to large businesses or the export market.

Businesses in the sample were generally unsophisticated in their use of **communications technology** – only 21 percent used computers and 14 percent used the internet in the running of their businesses. Use of the internet as a potential marketing tool is greatly under-recognised.

#### **4.1.2 Challenges facing small and medium businesses**

When asked to identify the major challenges facing their businesses, SME owners tended to focus on their immediate circumstances, with little reference to their broader business environment or regulatory issues.

**Lack of demand** (or lack of customers) was identified as the biggest challenge facing SMEs. The prominence of this response is indicative of the largely undifferentiated nature of SMEs' product offerings and lack of competitiveness in a very small market. Resentment of **competition** from Chinese and Indian-owned businesses emerged as a strong theme.

Businesses in more remote locations (in rural areas of the Mountains and Foothills Zones) were most dissatisfied with their **access to markets** and potential customers – reflecting their relative isolation from larger urban centres. There are very **limited linkages** between small firms and larger (often foreign-owned) businesses operating locally, and this further restricts SMEs' potential market access. SMEs suggested that opportunities to access **government contracts** are largely unavailable – their experience is that the GoL prefers to contract with larger businesses that are able to deliver in quantities against short timeframes which are beyond the capacity of most SMEs.

Other key challenges identified by businesses included **high operational costs**, inadequate **infrastructure** and **cash flow** problems, particularly as a result of late payment by customers, including government.

The **limited range of suppliers, and particularly wholesalers**, within Lesotho reduces SMEs' purchasing options; and the consequent need to travel to South Africa to source inputs for their businesses increases costs for SMEs and requires business owners to spend a great deal of time not only travelling to suppliers outside the country, but also obtaining the necessary **import permits** and spending long hours at border crossings waiting for their goods to be processed by **customs** authorities on both sides of the border.

**Access to finance** was also a prominent issue for SMEs. The extent to which the sample was primarily comprised of survivalist and very small businesses translated into two thirds of the sample reporting that they had never approached a commercial bank for finance. Just over half the surveyed businesses had relied entirely on their own savings or family savings in establishing the business and had not accessed credit at all. The general perception was that bank loans and overdraft facilities were largely inaccessible to small and micro businesses.

Among those businesses that had accessed external finance, well over half had relied on family and friends, while two fifths had secured a loan/overdraft from a commercial bank.

The most commonly mentioned factors making it difficult for SMEs to access finance from commercial institutions were **lack of collateral** and perceptions of high **interest rates**. However, money lenders provided a source of credit for nine percent of the firms surveyed, despite interest rates as high as 25 to 30 percent of the loan (per annum).

Almost a quarter of businesses surveyed noted that they were concerned about the level of **debt** owed by their businesses.

Forty-two percent of businesses said that they **did not know enough about regulatory issues** to comment on whether regulations were a problem for their business. A further six percent said that they had no problems with regulations. This is partly reflective of the informal and survivalist nature of many of the businesses in the sample, coupled with a strong focus on key concerns such as market access and competition.

Among businesses that were concerned about regulatory issues, 15 percent reported that tax is too high, six percent were critical of licensing regulations, five percent said that regulations favour foreign and big business. The extent to which administration of regulatory requirements requires in-person transactions between the business owner and the relevant government agency (which requires business owners to spend time standing in **queues** rather than running their businesses) was also of concern to some

respondents. As and when businesses grow and become more sophisticated, regulatory issues are likely to become more prominent.

For the most part, **tax registration and administration was generally regarded as problem free**, and the Lesotho Revenue Authority was commended for its effective communication and outreach to SMEs.

The exception however was **customs regulations and administration**, including VAT refunds on imported goods, which represented a significant challenge for SMEs. Problems included the need to obtain different types of permits for different types of imports, each with different validity periods (and all of which must be obtained in Maseru); difficulties accessing VAT refunds from SARS on the South African side of the border; the number of forms that have to be filled in on both sides of the border, and the hours spent waiting in queues for goods to be cleared – all of which represent significant costs to SMEs.

#### 4.1.3 BDS and Government support

The very small scale on which the majority of surveyed SMEs operate, together with their limited capacity to grow their businesses as a result of saturated markets, cash flow problems and poor access to credit, result in a **weak demand** for business development support (BDS).

Family, friends and other business owners are the most frequently consulted sources of advice on starting or running a business among SMEs. Only 14 percent of the sample had received advice or support from government bodies (including MTICM, LNDC and BEDCO). Well over half the sample said that they had never accessed BDS.

Among the 42 percent of business that have accessed BDS in some form at least once (this includes advice received on an informal basis, from friends or other business people, as well as services obtained from formal BDS providers) , **book-keeping** and **training** were the most commonly accessed services.

**Lack of knowledge** or information about the services was identified by SMEs as the main reason that they had not accessed BDS, while 15 percent of SME owners said they were too busy or uninterested to access such services.

**Key priorities** for government support as identified by SMEs included **access to finance**; improved access to reliable **infrastructure**, premises and facilities for serviced **market-places**; access to equipment and technology, regulatory reform in the area of **customs** procedures and VAT requirements on imported goods; and greater access to, and transparency in the issuing of, **government tenders**.

#### 4.1.4 Policy recommendations

In recent years, Lesotho has been subject to a plethora of studies and initiatives aimed at encouraging private sector development. A range of policy programmes currently in place and under development have the potential to make real improvements to the conditions under which small businesses operate, if implemented effectively.

On the basis of the survey findings, and taking into account relevant initiatives and programmes with a bearing on SME development, the project report puts forward a number of high-level policy recommendations. These recommendations reiterate many of the main themes of the *White Paper on small business development* – many of which have yet to be implemented in a manner which is coherent, sustained and effective.

The GoL recognises that its role is to facilitate SME development, by creating an enabling environment and facilitating access to appropriate tools and support mechanisms to enable SMEs to develop their capacity. The recommendations are based on this premise. It is important to recognise that SME growth can take various forms along a continuum of business activity, and that efforts to support and grow the SME sector need to be firmly rooted within the broader economic growth strategy.

**Priority issues** in the short term include the need to:

- **Resolve the institutional allocation of responsibilities for SME support.** This requires clarifying the roles and responsibilities of the various GoL departments and agencies with mandate for SME development (specifically MTICM, Ministry of Finance and Development Planning, LNDC, BEDCO), improving communication and coordination across agencies, and raising public awareness about these respective roles and how to access support.
- Explore creative mechanisms to **facilitate improved access to markets** for SMEs. This should include efforts to encourage and **support business linkages programmes**, which will require effective collaboration between LNDC and BEDCO. Initiatives could include:
  - A requirement that deals securing new foreign investment include an examination of possibilities for local linkages
  - Facilitation of improved information flows between large and small business
  - Forums bringing together large and small businesses to discuss procurement issues
  - The development of SME databases that can be accessed and used by big businesses, to improve their awareness of available services/products and capacity among local SMEs.
- **Expand government procurement to SMEs.** Efforts are needed to review current policy and practices in government procurement to identify possible impediments to SMEs. This process could be led by the Ministry of Finance and Development Planning, and would require cooperation from all GoL departments. Initiatives to improve GoL practice in this regard could include:
  - Actively targeting SMEs when advertising smaller tenders

- Reviewing timeframes for tendering and delivery (wherever possible) to enable improved access by SMEs, and
- A firm commitment from all government departments and agencies to pay SMEs within specified timeframe for contracted work.
- Encourage and **facilitate the establishment of effective mechanisms for business collaboration**. Institutions such as BEDCO and LNDC could play a useful role in working with business associations to create effective mechanisms for representation of SMEs, including the establishment of sector-specific clusters/local associations of SMEs to achieve shared objectives
- The MTICM and the Ministry of Finance and Development Planning need to play an active role in **developing and encouraging a culture that recognises and values entrepreneurship**. This should include the development of vocational training programmes directed towards encouraging and developing entrepreneurial skills (in association with the proposed Lesotho Skills Agency<sup>2</sup>) in line with international good practice; engaging with private sector companies (in Lesotho and South Africa) to encourage the establishment of internships; promoting entrepreneurship through publicity campaigns and incentives (e.g. annual awards for which young entrepreneurs can compete, providing both media exposure for finalists and examples of success for aspirant entrepreneurs); and facilitating forums for knowledge sharing among SMEs (for example at BEDCO sites).
- The GoL is committed to **improving the provision of physical and communications infrastructure**. This requires coordinated planning of infrastructure projects across departments and agencies, and interaction between MTICM and other departments to ensure that SME needs are recognised and addressed.
- The GoL and the commercial banking sector are making good progress in the implementation of initiatives designed to **improve SMEs' access to finance**. Current initiatives (2008) include the establishment of a Credit Bureau, introduction of a Partial Credit Guarantee Facility, and evolution of the Post Bank into a credit provider. Further work in this area could include the exploration of opportunities for alternative forms of collateral, such as capital equipment/secure contracts, as well as communication targeted at SMEs to better inform them of the options available to them and where to access support. It would also be useful for BEDCO/LNDC to explore with commercial banks possible mechanisms to provide support to first time borrowers and develop book-keeping and financial management skills among SMEs.
- **Minimise administrative inefficiencies** associated with customs procedures and issuing of licenses and permits. It is recommended that business licensing processes be restructured to focus more strongly on information gathering rather than fee-generation.<sup>3</sup> The regulatory framework governing land tenure

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<sup>2</sup> The draft TVET policy recommends the introduction of “semi-autonomous” Lesotho Skills Agency (LSA) and Sector Skills Committees (SSC) within this institution to formulate the relevant needs of the various sectors of the labour market.

<sup>3</sup> As per the recommendations of the 2002 *White Paper on the development and promotion of small business*

and business ownership should be reviewed with a view to encouraging joint ventures between foreign firms and SMEs (with SME as minority owner/shareholder). Customs procedures and permit requirements for imported materials need to be streamlined in order to support GoL's objective of encouraging growth-oriented SMEs that are able to produce to the scale and timeframes demanded by export markets.

- **Improve information on SMEs.** Different government departments and sector specific agencies with a responsibility for business licensing should collate and share information on numbers and types of SMEs in different sectors, to generate a more holistic picture of SME activity in the country.

In the longer term, the GoL will need to:

- **Focus both on developing skills** among small business owners and employees, **and expanding the horizons of business people** and potential entrepreneurs (with a particular focus on young people and business start-ups, as well as more established SMEs). This will need to go beyond implementation of the TVET policy, to incorporate broader skills transfer mechanisms. These should include exposure to dynamic businesses and business practice through business linkages, internships in successful companies for promising entrepreneurs, and reward programmes that select competitors to travel to other countries to learn from successful business practice (such initiatives should target school leavers, university students and SME owners)
- **Encourage greater integration of Lesotho-based businesses in the regional economy** and promote cross-border business linkages. Efforts in this regard will need to incorporate regulatory reforms, including the streamlining of customs procedures, import permits and visa regulations. It will also be important to improve SMEs' awareness of and access to information about export opportunities and associated requirements. BEDCO and LNDC could play a useful role in facilitating improved access to information about market opportunities and how to access these. Sector specific associations should play an active role in improving the integration of Lesotho businesses in the regional economy. The Lesotho Tourism Council for example has an important role to play in facilitating Lesotho's integration into the Southern African tourism market.

## 5. Introduction and background to the study

### 5.1 Project Objectives

Recent studies estimate that small businesses comprise at least 85 percent of Lesotho's private sector.<sup>4</sup> The 2008 Lesotho Review estimates that there are some 100 000 SMEs in the country. Most of them are informal. The majority are sole proprietors employing between one and three staff members. The sector is estimated to employ nearly 200 000 people altogether, in both the formal and informal sectors.<sup>5</sup>

At present, Lesotho is characterised by low levels of private sector activity and investment. The public sector absorbs nearly half the GDP. In order to reduce the economy's dependence on the public sector, the government aims to encourage rapid and sustained private sector development and increase the productive base.

The MTICM *White Paper on the development and promotion of small business*<sup>6</sup>, drafted in 2002 and subsequently adopted by Cabinet, identified a number of key challenges facing small businesses in Lesotho, including limited access to finance, skills shortages, the high cost of doing business, regulatory problems, and the lack of integration of local small businesses in supply chains.

The White Paper set out key areas for government reform of the regulatory framework affecting enterprises, and outlined strategies to support the development of markets through improved information and business linkages. However, progress in implementing many of these recommendations has been very slow<sup>7</sup>.

The objective of the *State of Small Enterprise* project, as defined in the Terms of Reference, is to better inform Government enterprise support programming. This includes issues such as small enterprises' access to services, the market for business development services (BDS), and access to appropriate financial products for small businesses. The study was designed to provide authoritative quantitative and qualitative information on small enterprises in both the formal and informal sectors to underpin policy development in these areas.

The focus is on micro, small and medium businesses in a variety of sectors. The study examines business activities and operating environments in a range of settings and geographical locations across the country – including those in isolated rural communities beyond easy access to markets and tarred roads. The study presents an

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<sup>4</sup> Capacity Building Plan for the private sector in Lesotho, Ministry of Finance and Development Planning, ECI Africa Consulting, March 2006

<sup>5</sup> Lesotho Review: An overview of the Kingdom of Lesotho's economy, 2008

<sup>6</sup> Drafted by SBP in collaboration with Bannock Consulting

<sup>7</sup> Workshop on re-aligning Government of Lesotho's SME support programming, September 6, 2006: Report on 'ways forward'

in-depth picture of business activity, together with the characteristics of enterprises and business owners and employment patterns, in a range of sampled areas representing a cross-section of the country.

The project findings are based in a combination of input from the project reference group, in-depth engagement with role-players in government and the private sector, a large-scale quantitative survey of small businesses in both the formal and informal sectors, and in-depth case study interviews with selected businesses to explore key issues.

The study provides important data on small and medium businesses in the country as a whole, together with analysis of the perceived opportunities and constraints facing Lesotho's SMEs. It provides information about:

- The characteristics of business owners, in terms of factors such as gender, age, levels of education, and nationality
- Key characteristics of small businesses, including number of employees, types of employment contracts and gender composition of workforce; range of activities; and longevity of businesses
- Tax registration and license/permit types held by different types of business
- Patterns of business growth
- Challenges and opportunities facing small enterprises, including access to finance, access to markets, business linkages, availability of and access to core infrastructure and services, use of technology, and regulatory issues
- Awareness of and access to advice and business support services, and perceived gaps in current government support in this area
- The impact of HIV/AIDS on small businesses

## **5.2 Project terms of reference**

The Terms of Reference required two inter-related information gathering processes. The first was a formal quantitative survey of enterprises, and the second a smaller qualitative study.

The Terms of Reference specified the following outputs for the quantitative component:

- Estimates on the number of enterprises, both formal and informal
- Distribution of enterprises by size and type (full and part time employed)
- Distribution of enterprises across the country
- Breakdown of the types of enterprise activities.

The, complementary qualitative study would focus on a stratified selection of a small number of enterprises from the larger sample, for the purpose of in-depth, case study interviews. The Terms of Reference looked for the following information from the qualitative survey:

- A detailed analysis of the types of constraints faced by enterprises, i.e. finance, skills, access to opportunities, input supply and infrastructure
- The nature of demand for business development services

- Analysis of regulatory barriers to operating in Lesotho.

In practice, the methodology employed by SBP, and approved by the client, elicited much of this information by way of the quantitative survey; while in the qualitative component issues were explored in greater depth in interviews with selected businesses and other key informants.

The Terms of Reference defined the project deliverables as follows:

- An approved work-plan translated from the successful proposal for carrying out the survey, including the dissemination of its results to identified clients
- A clearly presented methodology, implemented to deliver the two outputs of this survey along with a way of best applying the results and among whom so that the outputs impact on the survey's objective
- A consolidated database of the enterprises used for the formal survey including the results for each of those sampled
- A final report that provides a description and analysis of the results from both survey outputs and concludes in relation to the survey's objective, cross-referencing the survey findings with other applicable studies

## **6. Project Approach**

The project was undertaken in three phases, running from December 2007 to September 2008. A project reference group, comprising public and private sector representatives, provided oversight.

### **6.1 The project reference group**

Lesotho's business sector has been subject to a wide range of research and policy reform initiatives in recent years, many of which have had limited impact. A primary reason for this has been a lack of buy-in from government and other local stakeholders, and a failure to adequately reflect local knowledge and resource constraints. In contrast, the *State of Small Enterprise* project was designed on the basis of strong participation and ownership from key role-players in government and the private sector from the very beginning of the project.

A project reference group was convened at the start of the project, comprising representatives of MTICM, PSP, the Ministry of Finance, LNDC, BEDCO, the Bureau of Statistics and Lesotho PostBank, among others, together with various representatives of organised business and individual business people. The reference group was chaired by Ms. Motsamai, Director of Industry at MTICM, and provided input and feedback at key stages of the project.

### **6.2 Methodology**

#### **6.2.1 Phase 1: Initial research and engagement with stakeholders**

A detailed description of the project methodology is contained in Annex 2A. This section provides a brief summary of the project approach and activities.

Phase 1 of the project ran from December 2007 to early March 2008. This phase focused on developing a clear understanding of the current policy and regulatory environment governing small business in Lesotho, and meeting with key stakeholders in government and the private sector. Organisations consulted included the MTICM, members of the Ministry of Finance growth strategy team, BEDCO, and the Lesotho Chamber of Commerce, among others.

During this stage SBP undertook a desk review of relevant policy documents and research reports, to provide a broad understanding of the current policy and regulatory environment and identify existing institutions and initiatives with a mandate to support small business development. SBP also met with other donor agencies engaged in related research projects in Lesotho, including the World Bank, in order to clarify respective activities and ensure synergies rather than duplication of effort.

SBP's survey methodology was refined further, the quantitative survey questionnaire was developed, and the sampling framework was constructed and survey sites selected. The Bureau of Statistics provided very valuable assistance in making

available their Register of Business to inform the sampling process, and providing advice on the sourcing and recruitment of appropriate enumerators to undertake the quantitative survey.

### 6.2.2 Phase 2: The quantitative survey

The quantitative survey covered a sample of 610 enterprises in selected sites across Lesotho. Both formal and informal enterprises were included in the survey. The focus of the study was on small and medium enterprises (SMEs), defined in terms of the White Paper.

#### Definition of small businesses

The MTICM *White Paper on the development and promotion of small business* defines a small business as “a firm that is independently owned and owner-managed and has a small market share.” It classifies businesses as micro, small or medium based on staff numbers:

|                   |                            |
|-------------------|----------------------------|
| Micro-enterprise  | Fewer than 3 staff members |
| Small enterprise  | 3 to 9 staff members       |
| Medium enterprise | 10 to 49 staff members     |

The sample provides a broadly representative picture of the experiences, challenges and perceived needs of small businesses in Lesotho<sup>8</sup>. Lesotho’s Livelihood Zones were used as the basis for stratifying the sample. The broad characteristics defining each Zone provide a useful basis on which to differentiate the sample, allowing recognition for the broadly urban nature of the Southern Lowlands compared to the largely rural and remote nature of communities in the Mountain Zone, for example.

### 6.2.3 Phase 3: Case-studies and additional stakeholder discussions

Phase 3 included in-depth qualitative/case-study interviews with selected small business, as well as representatives of big business and organised business and government departments and agencies. The focus of the qualitative study was on finding out more about what a range of public and private sector stakeholders perceive as the major constraints to SME sustainability and growth, and the sorts of interventions that the public and private sectors could potentially develop to address these challenges.

Phase 3 also provides for the compilation of material to support the dissemination of the project findings to relevant role-players, and to the broader Lesotho business community.

## 6.3 Contextualising the results

It is necessary to note that the project did not attempt to undertake a census of small business activity across Lesotho, or estimate the total number of small enterprises in

<sup>8</sup> Full details of the sampling framework and methodology are provided in **Annex 2A**.

the country. It is not possible to provide such an estimate with any accuracy, given the limited nature of existing data on the number and distribution of enterprises in Lesotho, which would be required to weight up the survey results for the national population. This issue was discussed and agreed with the project reference group.

What the project does provide, is a robust and reliable in-depth picture of business activity, together with the characteristics of enterprises and business owners and employment patterns, in a range of sampled areas representing a cross-section of the country.

The survey sample did not try to approximate the proportion of formal to informal businesses in the country as a whole.<sup>9</sup> While it was theoretically possible for the survey to reflect the proportion of formal to informal businesses in the chosen sites, this objective had to be balanced against the need to gather meaningful data on the constraints to growth faced by SMEs which are not merely survivalist. In a strictly random sample, the vast majority of the businesses interviewed would have been micro and informal. The extent to which a very large proportion of businesses are informal was clearly apparent in the field. Interviews with these enterprises revealed a strong focus on immediate survivalist issues, including shortage of customers and inadequate, make-shift premises. While it was important to capture the profile and needs of these businesses, it was also imperative to target businesses with potential for growth, which could articulate a range of business constraints and needs, in order to inform the development of policy recommendations.

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<sup>9</sup> The Household Budget Survey 2002/03 asked respondents to indicate if anyone in the household was involved in a business. Eighteen percent of households indicated that they were involved in a business, 8 percent of which were registered. If one uses this as a rough approximation of the size of the business sector in Lesotho, it is clear that a large proportion of businesses in Lesotho are informal – possibly as high as 92 percent.

## **7. Project findings**

The primary objective of the *State of Small Enterprise* project is to provide information to inform the Government of Lesotho's programmes for enterprise support. This requires information on the distribution and activities of small and medium enterprises and the characteristics of business owners, as well as an exploration of the challenges and opportunities faced by small enterprises in terms of access to finance, access to markets and potential business linkages, issues relating to infrastructure, technology and regulation, and awareness and use of business support services.

This section presents the key findings of the project, based on a quantitative survey of over 600 small and medium businesses, supplemented by information and observations derived from the smaller qualitative survey and interviews with key informants.

As noted above, the results of the quantitative survey have not been weighted up for the Lesotho business population as a whole. Regarded from a rigorously statistical point of view, a word of caution about strict representivity is thus in order. Nevertheless, the data incontrovertibly provide a very strong indicative picture of the range of businesses in the formal and informal sectors, their key challenges and the constraints to their growth, and priority areas for improved support from government.

### **7.1 Key characteristics of the SME sector in Lesotho**

#### **7.1.1 The large majority of SMEs are micro-enterprises**

One of the primary findings of the study, which is supported by a range of other surveys of economic activity in Lesotho, is the huge predominance of micro-enterprises in the SME sector. Indeed, in a strictly random sample, the vast majority of businesses interviewed would have been informal micro-enterprises.

Seventy percent of businesses in the sample were micro-enterprises (with two employees or less). A striking finding is that one third of micro-enterprises businesses had no employees at all other than the owner. Twenty three percent of enterprises in the sample were small businesses (3 – 9 employees).<sup>10</sup> Only seven percent were of medium size, with between ten and 50 employees.

The responses of medium sized businesses (defined in terms of employee numbers) to the survey questions did not generally differ significantly from those of smaller businesses. The category was therefore not very revealing for analytic purposes.

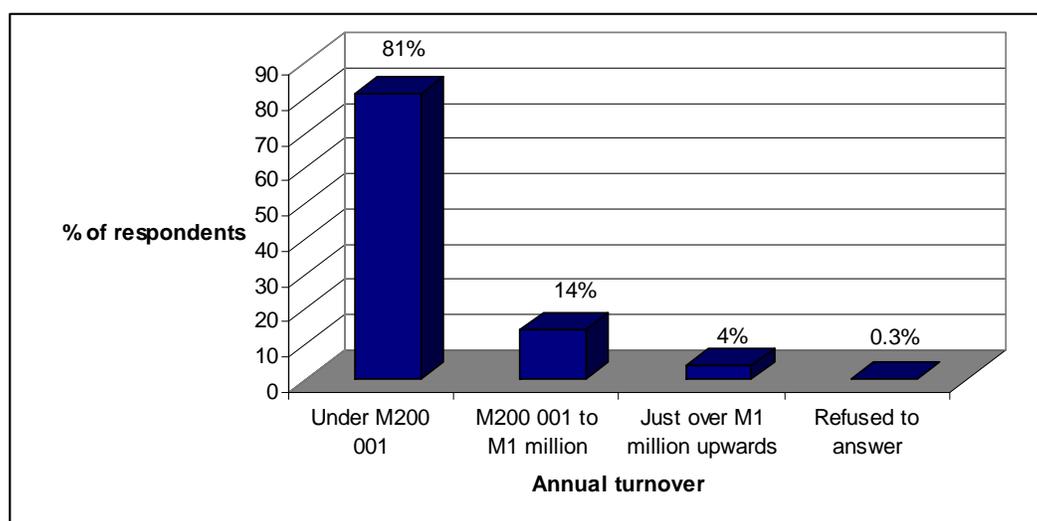
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<sup>10</sup> Of these small businesses, ten percent had only three employees. Eighty percent of small businesses in the sample thus employ no more than three people – including the business owner. This raises important questions about the SME sector as a vehicle for job creation. The policy issue must be to grow the size of small businesses.

Annual turnover, whilst difficult to ascertain with accuracy, provided a useful alternative indicator of business size and sophistication, and possibly of potential for growth. The sample was therefore analysed by turnover as well as employee numbers.

Eighty percent of businesses reported annual turnover below M200 000. In fact, almost a quarter of respondents reported annual turnover of under M10 000 per annum – which is very low indeed. Less than four percent reported turnover above M1 million, and less than one percent reported turnover above M5 million. These results indicate that the very large majority of small businesses are survivalists, and may have limited potential for growth and expansion.

**Figure 1: Composition of sample by annual business turnover<sup>11</sup>**



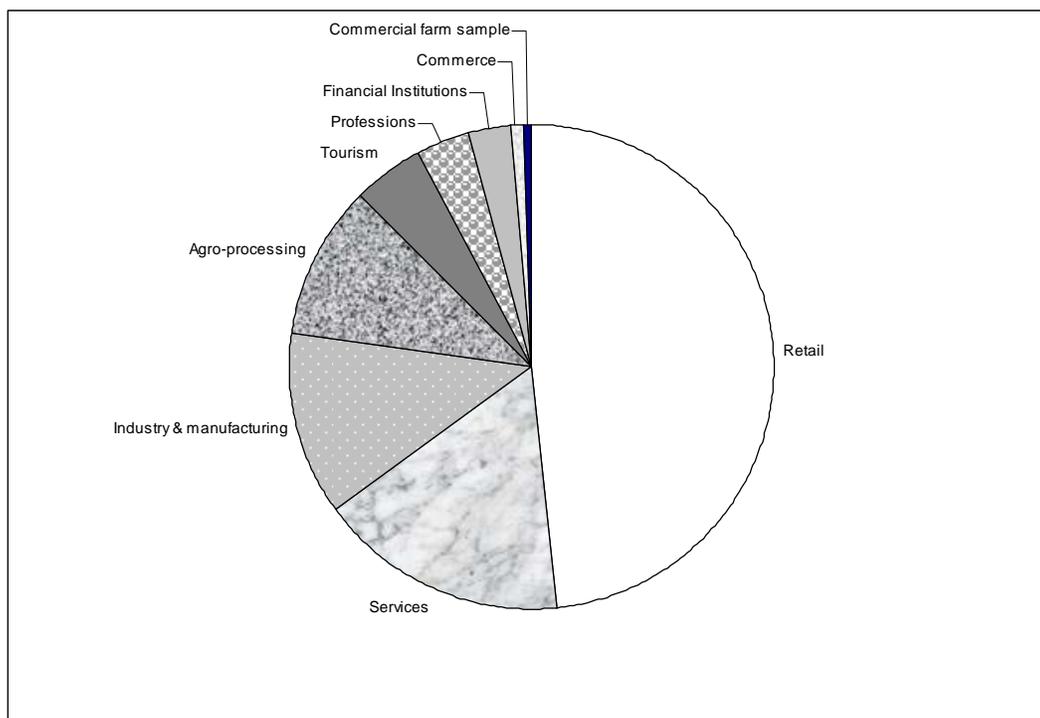
It should be noted that data on business turnover is notoriously difficult to gather accurately in surveys relying on respondent estimates. The turnover data collected for the current study is no exception, and results should be read with caution. It is likely that annual turnover is grossly underestimated in many cases. This is particularly likely for very small and/or informal businesses in the survey, most of whom do not keep accurate financial records (although it is possible that many of the micro and informal enterprises surveyed do have a very low turnover).

### **7.1.2 The large majority of SMEs are in the retail and service sectors**

The majority of SMEs covered by the survey were retailers, followed by businesses offering a range of services. Businesses in the industry/manufacturing sector and agro-processing made up fairly small proportions of the sample. Even smaller numbers of businesses were involved in the tourism, professions or financial sectors.

<sup>11</sup> n=575

**Figure 2: Breakdown of businesses by sector**<sup>12</sup>



It is not surprising that the survey sample was largely skewed toward the tertiary sector, and specifically retail. Secondary sector businesses such as textile manufacturing and construction tend to be dominated by larger businesses, and are often characterised by substantial start-up and operating costs. Retail and services, in contrast, which together account for 70 percent of the sample of small businesses, provide relatively easy market entry for small and micro firms in both the formal and informal sectors, require relatively little start-up capital at the smaller end of the market, and for the most part require no specific formal training.

Businesses included in the retail sub-sector comprised a range of enterprises from mini-supermarkets and general dealers, to shops selling furniture, clothing and stationary, to sellers of airtime and informal sector hawkers. The services sub-sector included repair services, hire of equipment, transport services and couriers, and personal services such as hair dressers and beauty salons.

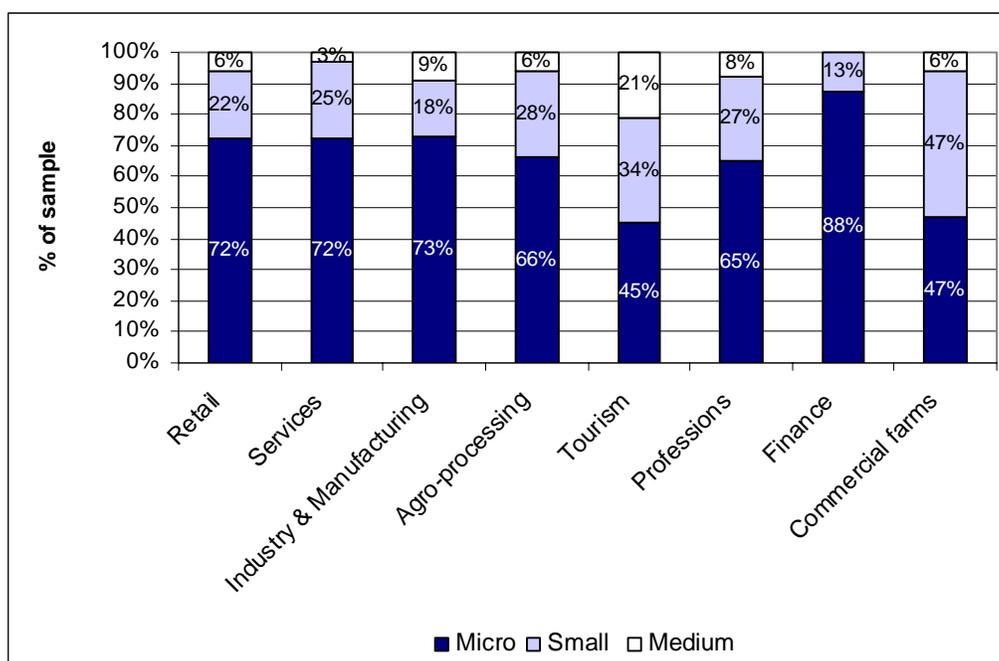
Tourism was treated as a separate sub-sample within the survey, given the sector's high growth potential. The *Growth Strategy Paper* estimates that the sector currently comprises between two and four percent of Lesotho's economy. The small enterprise

<sup>12</sup> The number of businesses that fall into each sector adds up to 644. Some businesses described activities that spanned two sectors. Where it was possible to ascertain what the primary business activity was the business was coded into this sector. Where this was not possible, two codes were assigned to the business based on the rationale that if a business undertakes activities across two or more sectors, the business will be affected by relevant conditions pertaining to more than one sector.

survey identified five percent of the sample as tourism businesses. These included restaurants and bars, accommodation, travel agents and tour operators.

Tourism businesses in the sample were more likely to be characterised by higher turnover and a larger number of employees than businesses in other sectors. The tourism sector was the only sub-sector to show a relatively high proportion of medium and small (rather than micro) businesses (55 percent). Seven percent of tourism businesses reported annual turnover above M1 million, against the sample average of four percent. Just under a third reported turnover between M200 000 and M1 million – in contrast to the retail, services, industry and agro-processing sub-sectors, where over 80 percent of businesses reported turnover below M200 000 per annum.

**Figure 3: Sample by size of businesses (number of employees) per sector<sup>13</sup>**



### 7.1.3 Most businesses are sole-proprietors

Seventy six percent of surveyed businesses were sole-proprietors – again confirming the tendency toward micro-sized, often survivalist activities among businesses in the sample.

Ten percent of businesses in the sample were companies, registered with the Registrar of Companies; and a further ten percent were partnerships.

Three percent were family owned, and were probably informal.

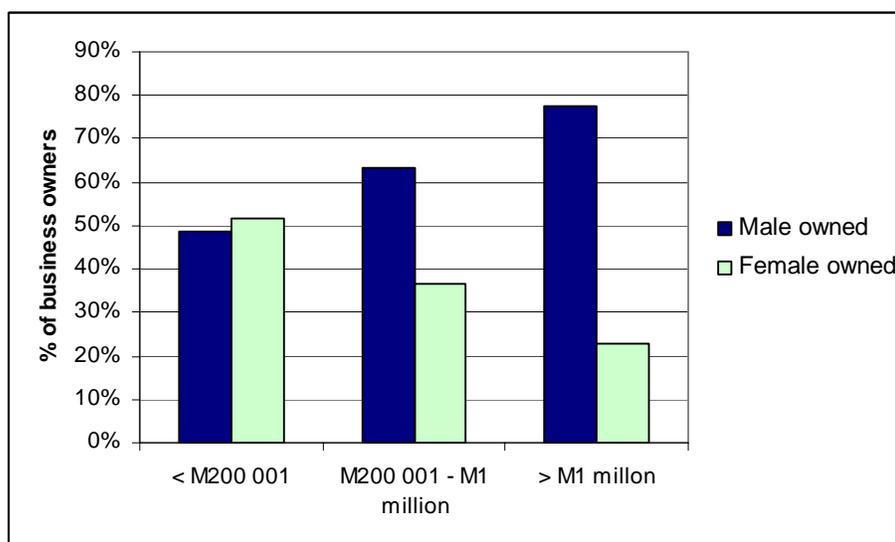
<sup>13</sup> n=610

For the large majority of business owners, the business was the only source of income generation. However, ten percent of surveyed business owners had other paid employment, mainly in the formal sector.

#### 7.1.4 Larger businesses are more likely to be owned by men, and foreign nationals

Businesses ownership was more or less evenly divided between males and females, but businesses with higher annual turnover were far more likely to be owned by men. Women were far more likely to own survivalist enterprises with turnover below M200,000 while 77 percent of businesses with over M1 million turnover per annum were owned by men.

**Figure 4: Breakdown of annual turnover by gender of business owner<sup>14</sup>**



This finding is interesting in light of the IPRGS, which states that many SMEs are run by women and young people and provide a ‘valuable means’ for them to participate in the economy. The fact that so many of the women-owned SMEs are at the very smallest end of the scale suggests that their participation in the economy continues to be on a very limited scale. The IPRGS notes that socio-cultural norms that place women as minors, combined with legal impediments, continue to disadvantage women in their access to and control over productive resources. It also notes that, while the 2003 Gender and Development Policy is starting to have an impact, the supporting regulatory reforms have yet to be carried out.

Respondents who, in response to the survey, defined their nationality as Chinese owned four percent of the businesses in the sample. While the large majority of businesses in the sample were owned by Basotho (92 percent), 85 percent of these businesses had turnover below M200 000 per annum. Just over half of the Chinese-owned businesses (55 percent) had turnover between M200 000 and M1 million, and

<sup>14</sup> n=572

14 percent reported turnover above M1 million per annum. In contrast to the Basotho owned firms in the sample, only a third of Chinese owned firms reported turnover below M200 000 per annum.

#### **7.1.5 Young people are under-represented among entrepreneurs**

Over half the businesses owners were between 30 and 50 years old.

Only 14 percent were between 21 and 30, and less than one percent were under the age of 21. This suggests a dearth of young entrepreneurs in the economy.

#### **Where are the young high-expectation entrepreneurs?**

A recent GEM-Mazars survey examines the incidence of “high-expectation entrepreneurship” across a range of countries in the developed and developing world. The study defines “high expectation entrepreneurs” as business people who declare their intention to hire 20 people or more over the next 5 years. The report notes that they are often starting points for new advances as well as for technical and technological innovations.

*These entrepreneurs are generally young (between 25 and 34 years old), have relatively high levels of education, and are motivated by risk taking – being ready to swap a comfortable salaried position in favour of a more uncertain but potentially more remunerative future.<sup>15</sup>*

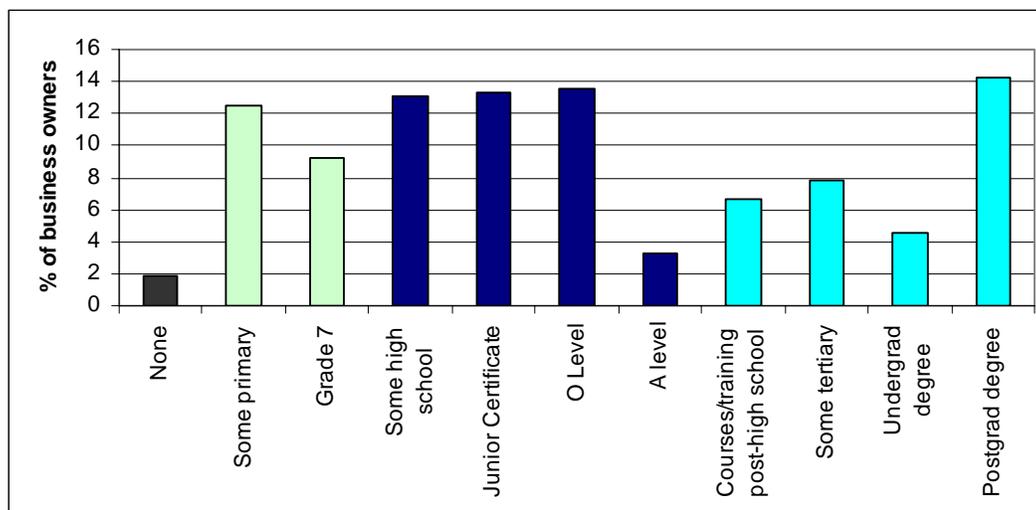
#### **7.1.6 One fifth of SME owners in the sample have tertiary education, while one fifth have primary school at best**

The study showed wide variation in education levels across the surveyed business owners. Nineteen percent had some tertiary education, and of these fourteen percent had post-graduate degrees. On the other hand, 22 percent had only primary school education (which was not necessarily complete).

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<sup>15</sup> GEM-Mazars International Survey on “High Expectation Entrepreneurship”, July 2008, [www.mazars.com](http://www.mazars.com)

**Figure 5: Education levels of SME owners**



### 7.1.7 Most SMEs employ full time staff, but often without formal contracts

Most businesses employed their staff on a full-time, paid basis. Across the sample, 92 percent of all employees were full-time. However, only 52 percent had employment contracts.

A third of respondents employ family members in their business, who accounted for 21 percent of total employees in the sample. Eighty three percent of businesses employ one or more employees outside the family. Just over 48 percent the total number of staff employed by businesses in the sample did not have employment contracts. Informally employment arrangements were present in both small and medium businesses – as many as a third of medium sized businesses in the sample employ at least some staff without formal contracts.

**Table 1: Breakdown of employee type<sup>16</sup>**

| Full time                | Part time <sup>17</sup> | Casual <sup>18</sup> |
|--------------------------|-------------------------|----------------------|
| 92%                      | 5%                      | 3%                   |
| Have employment contract | No employment contract  | –                    |
| 52%                      | 48%                     |                      |
| Paid                     | Unpaid <sup>19</sup>    | –                    |
| 97%                      | 3%                      |                      |
| Family member            | Non-family member       | –                    |
| 21%                      | 79%                     |                      |

<sup>16</sup> Full/ part time/ casual n=1586, Contract/ no contract n=1580, paid/unpaid n=1561, family / non family n=1451.

<sup>17</sup> For purposes of the survey, part-time is defined as 25 hours per week or less

<sup>18</sup> For the purposes of the survey, casual is defined as 'working for the business on an occasional/ non-permanent or irregular basis'

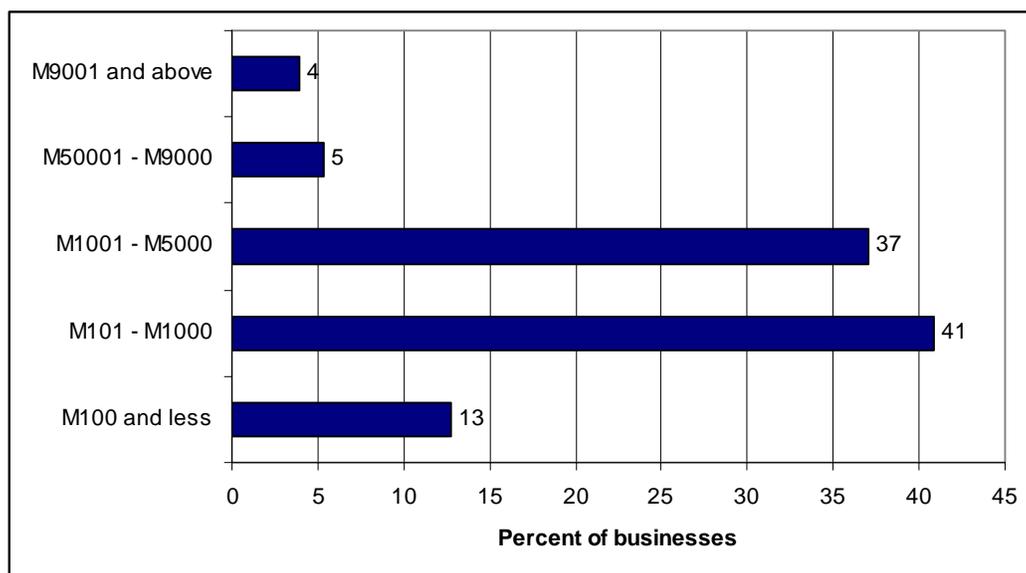
<sup>19</sup> 'Unpaid' refers to people who work for the business but do not receive monetary compensation, primarily family members of the business owner

### 7.1.8 Business premises are mainly rented and formal

Seventy eight percent of businesses in the sample operated from formal premises.

Sixty one percent of businesses rented their premises. Just under a third owned the property. Rentals showed a wide range, but were mainly concentrated between M100 and M1000 per month (41 percent of the sample) and between M1000 and M5000 (37 percent of the sample). The relatively large proportion paying between M100 and M1000 per month is indicative of the large number of informal businesses included in the survey.

**Figure 6: Breakdown of amount paid in rent per month<sup>20</sup>**



Qualitative interviews with representatives of big business noted the regulatory difficulties faced by entrepreneurs wanting to run a business from home. While it is apparently possible to get permission to have one's house rezoned for this purpose, the perception was that this is a difficult and time-consuming process.<sup>21</sup>

### 7.1.9 Larger SMES are more likely to be in the formal sector, and registered with LRA

For purposes of analysis, tax registration was taken to provide the most unambiguous definition of formality.

<sup>20</sup> n=359. The median rent paid was M900, and the mean was M1,952. The maximum rent paid was M15 000.

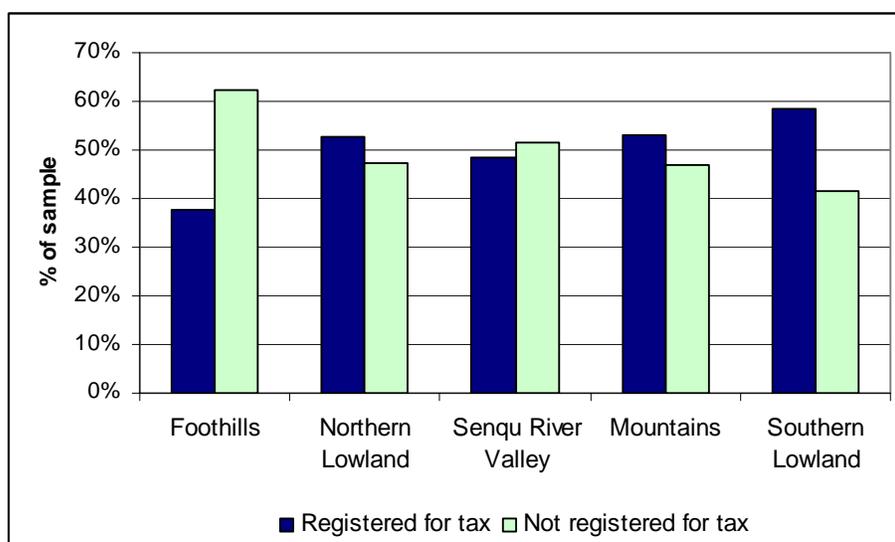
<sup>21</sup> In South Africa, the regulatory solution to this problem has been to allow for a specified percentage of the home to be used as the place of work (except for noise-producing businesses), thus enabling the relaxation of re-zoning requirements.

Just over half the businesses sampled reported that they were registered with the LRA. Tax registration increased with business size – almost 90 percent of medium sized businesses were registered for tax, compared to 40 percent of micro-businesses.

Fifty percent of businesses had a trade license from the MTICM – but only 84 percent of these said they were registered for tax (even though tax clearance is a requirement for the license). A further twenty percent had various other licenses, which are issued by a variety of government bodies dependent on the sector in which the business operates. Thirty percent of the sample stated that they had no official license or permit.

The Southern Lowland had the highest level of tax registration (58 percent), and the Foothills the lowest (38 percent). This distribution corresponds closely with the proportions of businesses holding some form of license per zone, with the exception of the Senqu River Valley, which has the fourth lowest level of tax registration, despite having the highest proportions of businesses with some form of licensing. In all other zones the proportion of tax registered businesses is about 20 percent lower than the proportion of businesses reporting some form of license.

**Figure 7: Tax registration per Livelihood Zone<sup>22</sup>**



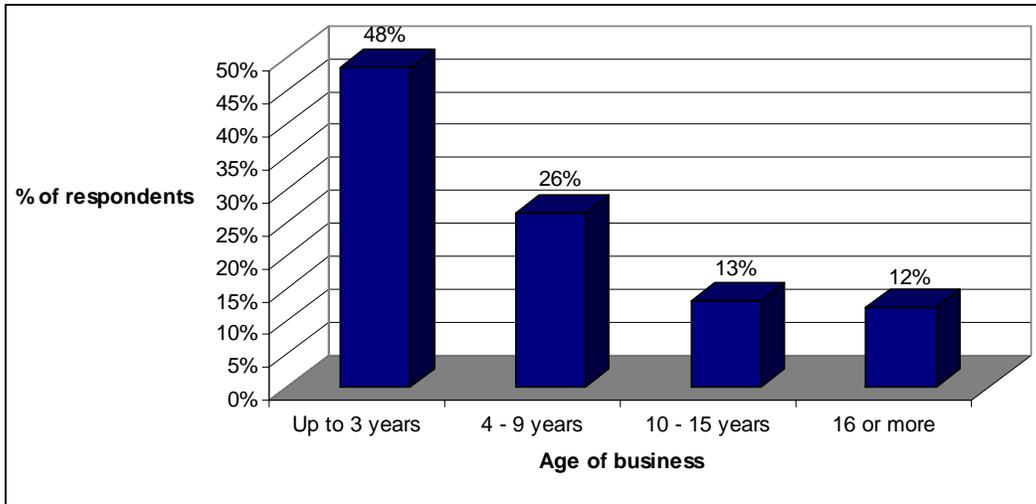
#### **7.1.10 Number of well-established and new businesses were evenly divided**

Most of the businesses surveyed had been in business for less than 4 years. However, a small number of businesses had been in operation for a very long period, which pushed the average age of the businesses across the sample up to 7 years.<sup>23</sup>

<sup>22</sup> n=606

<sup>23</sup> n=601

**Figure 8: Breakdown of sample according to age of businesses<sup>24</sup>**

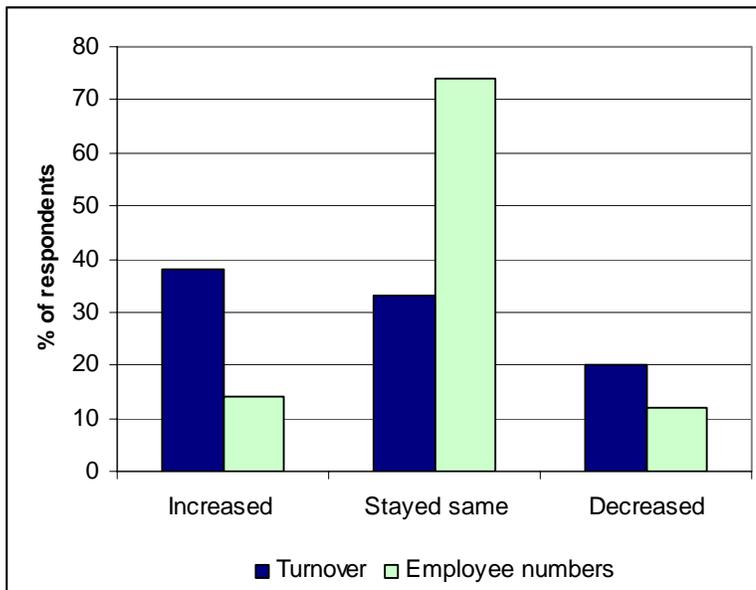


#### **7.1.11 Limited growth in turnover, little growth in employment**

Less than 40 percent of businesses said that their turnover had increased in the past three years. This figure is even more discouraging, when it is noted that reported increases in turnover may reflect inflation-related increases, given the absence of accurate financial records in many of the sampled businesses.

Only 14 percent of the businesses had employed additional staff in the previous three years.

**Figure 9: Business growth over the past three years, by turnover and staff size<sup>25</sup>**

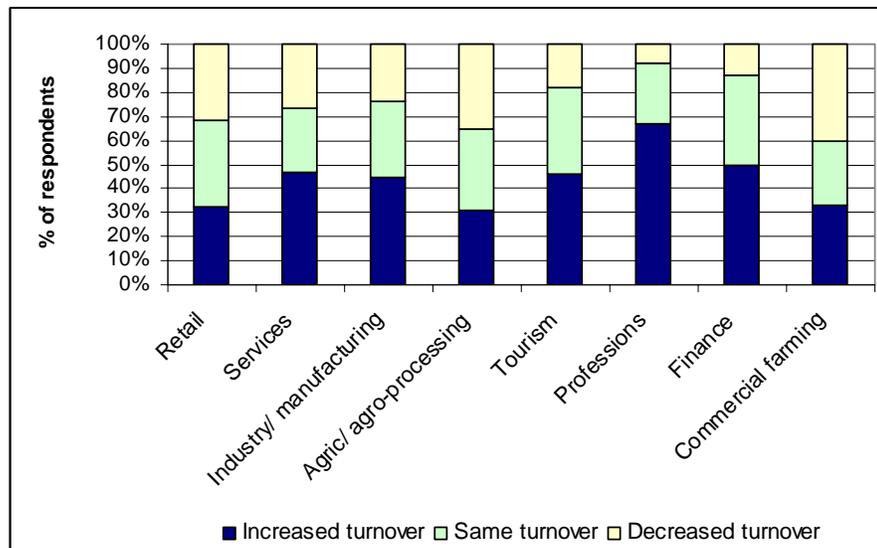


<sup>24</sup> n=601

<sup>25</sup> Turnover n= 581, employment n=586

Businesses in the professions, finance, tourism, services and industry sectors were most likely to have experienced growth. However, almost one third of retailers said that their turnover had decreased. Over a third of commercial farmers and agro-processors reported decreased turnover.

**Figure 10: Change in annual business turnover per sector<sup>26</sup>**



Interestingly, the survey results did not show a strong correlation between business growth as measured by turnover and whether the business was formal or informal (registered for tax or not registered). Forty percent of registered businesses reported increased turnover over the past three years, compared to 37 percent of non-registered businesses. Registered businesses were more likely to report a decrease in turnover (33 percent) than non-registered businesses (23 percent).<sup>27</sup>

No significant relationship was found between changes in turnover or employee numbers and the gender of the business owner.

There was also no significant correlation between changes in turnover or employee numbers and the length of time the business had been in operation.

Geographical location of businesses appears to bear a positive correlation with business growth as measured by increased number of employees. A larger proportion of businesses located in “main urban centres” and “small but well located” areas businesses reported increased staff numbers, compared to those in “not well located” areas.

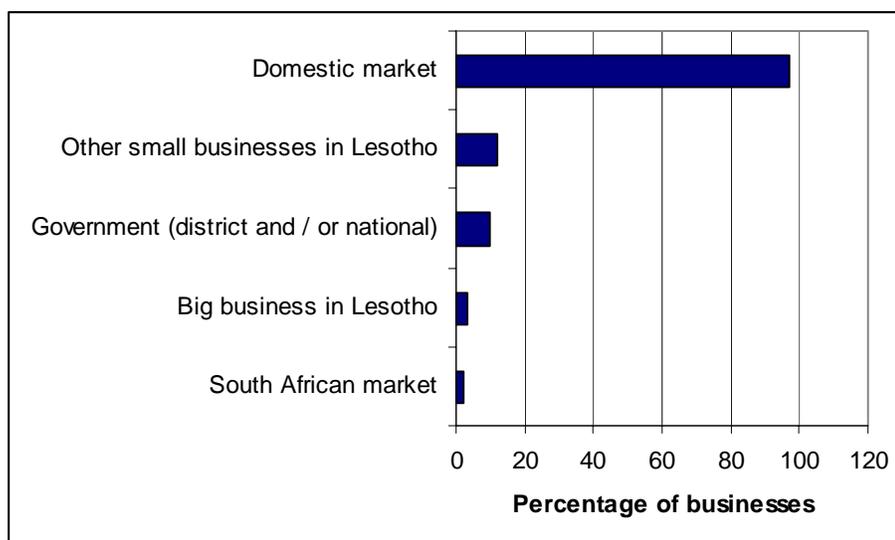
<sup>26</sup> Turnover n= 581, employment n=586

<sup>27</sup> n=576

### 7.1.12 Businesses don't trade far from home

The vast majority of businesses surveyed provided goods or services only to the domestic market, and generally only within the local area. Only three percent of businesses provided services or goods to big businesses or the export market. The picture was slightly different among commercial farms, where 20 percent served the South African market in addition to local businesses.

**Figure 11: Breakdown of markets supplied by surveyed businesses<sup>28</sup>**



### 7.1.13 Use of ICT is limited

While a large proportion (84 percent) of the sampled business owners used cell-phones in the running of their businesses, use of other basic office technology was generally low. Low levels of technology use were evident across the formal as well as informal sectors. Only 29 percent of sampled businesses had a land-line telephone, 21 percent used computers, and only 14 percent used the internet in running their business.<sup>29</sup> Cost appeared to be a strong inhibiting factor.

Businesses in well located urban areas were more likely to use ICT, as were business owners with higher educational levels. Higher proportions of businesses in the largest turnover band reported using computers and the internet (64 percent). Business owners with A-level or higher qualifications were considerably more likely to use a computer or the internet.

The extremely limited use of office technology across the sample reinforces the picture of a largely unsophisticated sector with limited horizons. While survivalist enterprises are unlikely to feel any need to computerise their activities, use of computers, email and the internet is essential for businesses seeking expansion through connections with the regional or global economy.

<sup>28</sup> n=610 - multiple response question, percentages can therefore add up to more than 100.

<sup>29</sup> n=609

Qualitative interviews with respondents found that those who are using the internet on a regular basis recognise that it provides a key competitive advantage for their businesses. However, the lack of technical skills within Lesotho causes headaches for regular internet users. Respondents noted that the broadband system goes down relatively often. When the internet system goes down as a result of technical problems, the business often has to wait for technicians to come all the way from Bloemfontein, because the necessary skills are not widely available locally. There was some speculation that Telecom Lesotho has not yet fully developed the necessary technological structures to support the system efficiently.

#### **ICT goals and objectives**

The GoL's strategic goals and objectives in respect of ICT include raising the number of internet users from two percent to ten percent by 2009, and increasing the percentage of Basotho who are e-literate from five percent to 30 percent by 2009.<sup>30</sup>

## **7.2 Challenges identified by SMEs**

A picture of an insular and largely unsophisticated SME sector emerged from the responses to questions regarding challenges facing small businesses. In many cases, businesses' articulation of issues was limited to their immediate circumstances, without reference to the broader business environment or regulatory issues.

Lack of demand (or lack of customers) emerged as the biggest challenge identified by SMEs. The tendency for small businesses to focus on 'lack of demand' is a fairly common response in any survey of this sort, and is also likely to reflect the uncompetitive nature of businesses.

Competition from other businesses was also a common response (15 percent of respondents) - suggesting lack of differentiation of products and services. Of those respondents who identified competition as a challenge, one third referred specifically to competition from Chinese or Indian businesses, and resentment of Chinese-owned businesses was a common theme throughout the survey.<sup>31</sup>

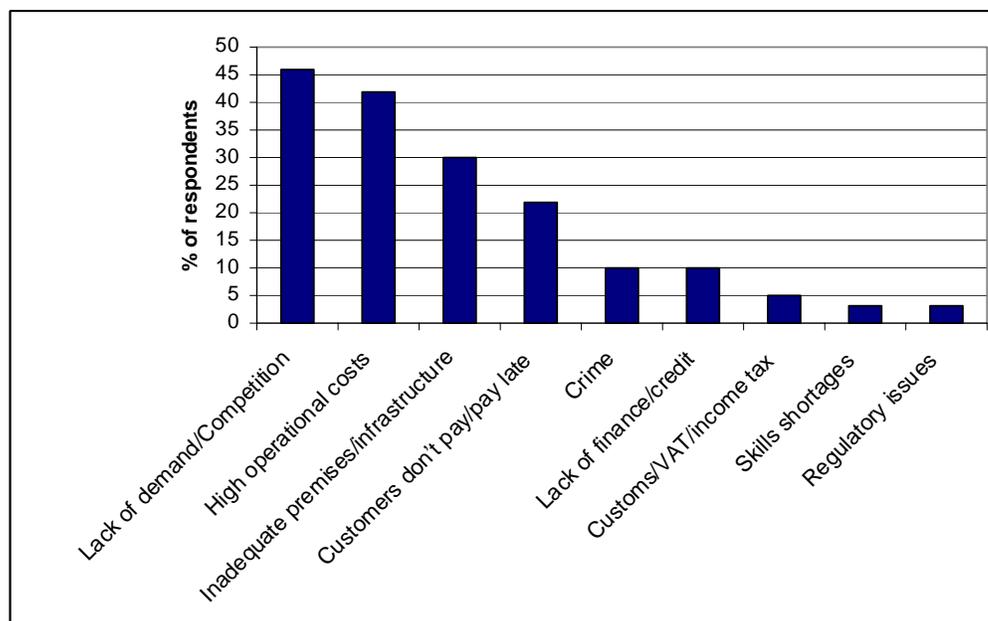
Other key challenges identified by businesses included high operational costs, inadequate infrastructure and/or unsuitable premises, and cash flow problems caused by customers (including government) buying on credit and paying late.

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<sup>30</sup> Lesotho Review 2008

<sup>31</sup> Interviews with small business owners revealed significant levels of resentment towards Chinese entrepreneurs in Lesotho. Respondents accused the Chinese of selling inferior quality goods and under-cutting their prices. A number of respondents displayed explicitly xenophobic attitudes toward Chinese business people.

Figure 12: Main challenges facing businesses<sup>32</sup>



### 7.2.1 Availability of and access to markets

#### Geographical barriers to market access

The large majority of surveyed businesses in the Northern and Southern Lowlands and Senqu River Valley reported that they were satisfied with their access to local markets for sale of their goods and services. In contrast, as many as 20 percent of respondents in the Mountains Zone and 30 percent of respondents in the Foothills Zone said that their access to local markets was inadequate – underlining the relative isolation of many businesses in these predominantly rural areas.<sup>33</sup>

#### Under-developed export markets

Lesotho-based small businesses are involved in exporting activities only to a very limited extent. Only three percent of survey respondents indicated that they provide goods or services to the South African market and/or other countries.

Qualitative interviews with business owners revealed high levels of concern about the risks associated with exporting (including currency fluctuations) and low levels of understanding about how to access possible opportunities.

There is a limited recognition of the potential value of the internet as a marketing tool and a means of accessing export opportunities. Many of the small business owners interviewed had undertaken very little marketing of their products. Respondents also suggested that the GoL has not actively engaged with small businesses to inform them on how to access export markets.

<sup>32</sup> n=596

<sup>33</sup> n=589

### Weak business linkages

Only three percent of surveyed SMEs (30 businesses) provide services or goods to big businesses.<sup>34</sup> For these SMEs, arrangements with big businesses include some formal linkages. However a third of the sub-sample said that they rely on informal arrangements with large businesses. Only a very small number of respondents in the sub-sample reported having direct access to other markets through export, and a similarly small number said that they access big business contacts or external markets through local business chambers or associations (three percent in each case).

Qualitative interviews with a number of larger businesses suggested that only one large textile factory is currently actively involved in developing business linkages (in collaboration with BEDCO), and that the initiative is at a fairly early stage.

Many of the large retailers in Lesotho are South African owned, making it very difficult for local small businesses to become suppliers to them, since their procurement offices are in Bloemfontein or Johannesburg. For this to change, large retailers would have to make a strategic decision to start buying locally. There is however a huge 'cultural gap' between large businesses and potential small suppliers. The ability of local small businesses to supply products to the specifications of the large retailers' procurement departments is often very limited.

### Government procurement

Given Lesotho's heavy dependence on government expenditure (which absorbs almost half the country's GDP) it is clear that access to GoL contracts is a key concern for small businesses.

When asked to identify the main things that the government could do to assist small businesses, seven percent of survey respondents called for greater transparency in the awarding of government tenders and/or eradication of corruption in the awarding of tenders.

Several business owners interviewed in the qualitative phase noted that the government does not tend to use local small businesses as suppliers. There was a perception that government prefers to use bigger businesses for its own procurement needs – including larger businesses from South Africa rather than local providers. This view was repeated by enterprises from the IT sector to legal practices and caterers, and was strongly supported by the Mohloli Chamber of Business. Respondents called for the government to review its own procurement policies with a view to strengthening the role of small business in their supply chain.

Small businesses also criticised the terms on which the government offers tenders – noting that the requirements and timing specified by government tender documents largely excludes local small businesses.

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<sup>34</sup> Defined in the survey as those with 50 or more employees

## Barriers to doing business with the GoL

According to one SME owner: "To react as quickly to a government order you would have to have good contacts outside and lots of financial muscle. You need a parent company you can call and have the material delivered in a short space of time, without paying for it yet. If you are small and have to buy things outside the country, you have to pay in advance, so you'll never do it."

### 7.2.2 High operational costs

Twenty-three percent of respondents said that high operational costs were a major challenge facing their businesses. Concerns about operational costs included high rental costs and labour costs, as well as limited access to tools, equipment and transport owing to the high costs of these inputs.

Eleven percent of businesses talked about limited access to local suppliers and the scarcity of wholesalers in Lesotho as key challenges. A large proportion of SME's production inputs are sourced from outside the country, primarily South Africa. This applies even to very small businesses. Sourcing supplies often involves a trip by the business owner him or herself - which substantially increases input costs. Many business owners undertaking the journey rely on public transport or lift sharing and trips often require several days. Respondents also noted that since they generally purchase fairly limited volumes, they are unable to access the discounts which benefit bulk buyers.

### 7.2.3 Inadequate infrastructure

Inadequate infrastructure was raised explicitly by 13 percent of respondents as a key challenge for their businesses.

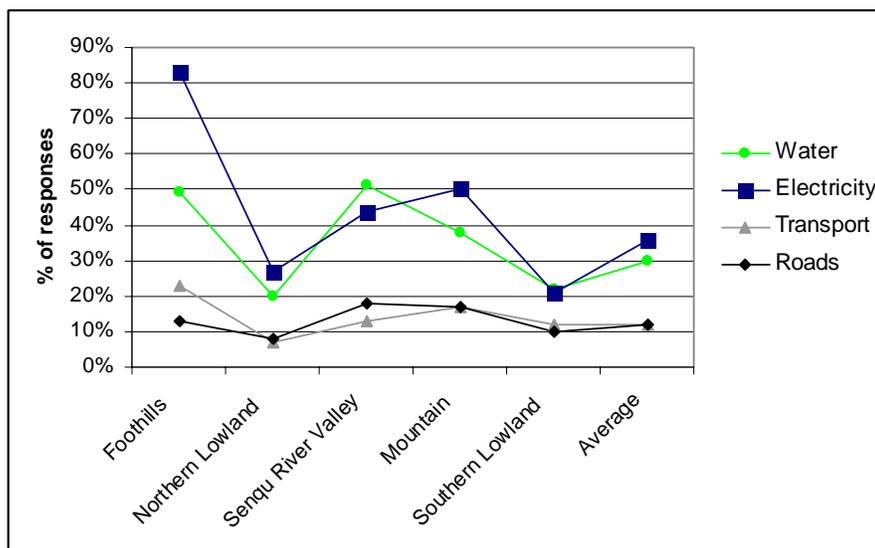
Just over a third of businesses had inadequate or no access to **electricity** and 30 percent had inadequate or no access to **water**. Access to electricity and water varied across the Livelihood Zones. Businesses in the Southern and Northern Lowland Zones, where survey sites were concentrated in the larger urban areas, reported better access to infrastructure than businesses in the other zones where sites were often more remote. In contrast, more than 80 percent of businesses in the Foothills Zone claimed inadequate or no access to electricity.

Infrastructure problems were particularly prevalent for businesses operating from informal premises, many of whom are not linked to services, are located in more remote areas with limited infrastructure or say that they cannot afford these services.

Inadequate access to **transport** and **poor quality roads** were identified as problems by about 12 percent of businesses in each case. Businesses offering professional and financial services, such as legal assistance and insurance brokering, and businesses in the catering industry, noted the huge cost and difficulty of accessing clients in more

remote locations. They said that business opportunities in these areas are often passed up because the associated travel problems outweigh potential income.

**Figure 13: Businesses with inadequate or no access to infrastructure, by Zone<sup>35</sup>**



The primary reason for poor access to water and electricity was lack of access *on the specific site* of the business – which accounted for 57 percent of responses among businesses with poor access to water and 47 percent for businesses with limited access to electricity. Limited infrastructure in the surrounding area was also a significant constraint on access to infrastructure, and was noted by over 40 percent of those respondents who had described their access to these services as limited. However it should be noted that a significant proportion of respondents without access to water and/or electricity said that their access was primarily constrained by their inability to afford these services (just under 20 percent of responses).<sup>36</sup>

#### 7.2.4 Late payment by customers, including government

Twenty-two percent of survey respondents described late payment by customers – including government – as one of the main challenges facing their businesses.

Qualitative interviews with small businesses across a range of economic sub-sectors highlighted the cash flow constraints created by late payment for work performed for the government. Business owners in the retail, tourism and manufacturing sectors all told a similar story: A government contract is awarded, the business has to pay its suppliers in cash or by cheque to secure all the necessary inputs, the job is completed, and the business owner then waits, sometimes for six months or more, to receive payment from government. The business is very unlikely to have credit facilities or

<sup>35</sup> Water, n=594, electricity, n=593, transportation, n=589, good roads

<sup>36</sup> Water, n=171, electricity, n=201

access to an overdraft, and is severely constrained from taking another order until payment is received and cash flow is re-established.

Government is of course not the only culprit. Small garment manufacturers noted that many of their clients buy on credit, and they often have to wait a month or two to be paid. They said that efforts to restrict credit to their customers would result in loss of sales.

### **7.2.5 Crime**

Mentions of crime focused mainly on theft by criminals outside the business. Crime was a more prevalent concern among Chinese-owned businesses, 54 percent of which listed crime as one of the top three problems facing their businesses. Concerns about crime declined as businesses decreased in size – while crime was mentioned as one of the top three problems by 22 percent of medium businesses, for small firms the figure was 16 percent, and for micro-enterprises only eight percent.

### **7.2.6 Access to finance**

Access to finance was by far the most frequently mentioned area in which businesses said they would like assistance from the government.

Just over half the surveyed businesses (51 percent) claimed not to have accessed external finance for their business – relying on personal savings to finance their start up and running costs.

Sixty-seven percent of businesses said that they had never attempted to access finance from a formal institution – the general perception was that bank loans and overdraft facilities were largely inaccessible to small and micro-businesses, most of whom are unable to furnish the necessary security for a loan.

Of those businesses that have accessed external finance (49 percent of the sample), 43 percent said that they access finance from formal banks, whereas well over half rely on family (31 percent) and friends (26 percent), as illustrated in figure 14.<sup>37</sup>

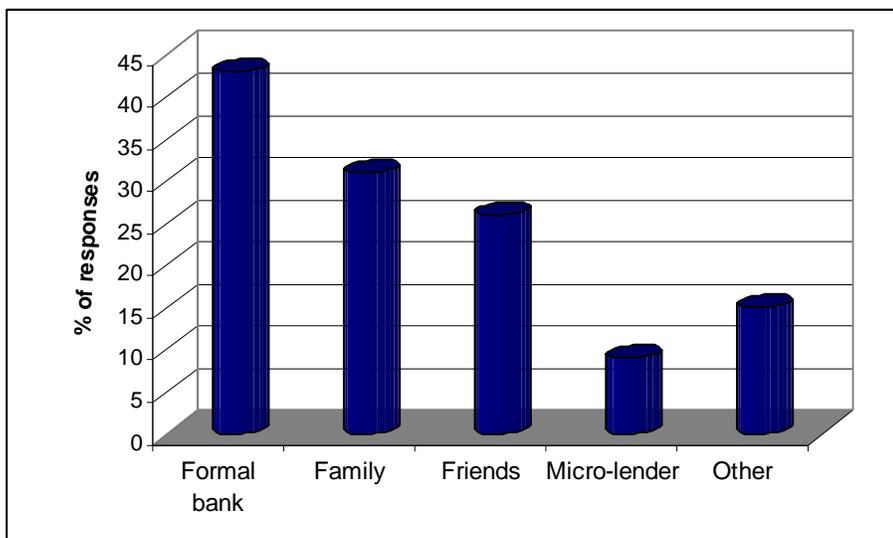
As might be expected, smaller and informal businesses were far more likely to report challenges to accessing finance from formal institutions. Twenty-one percent of respondents stated that they had had problems accessing finance or credit from a formal financial institution, while only twelve percent said that they had accessed finance from such an institution without any problems.<sup>38</sup> Many small businesses rely on money lenders – despite interest rates as high as 25 to 30 percent of the loan.

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<sup>37</sup> n=380

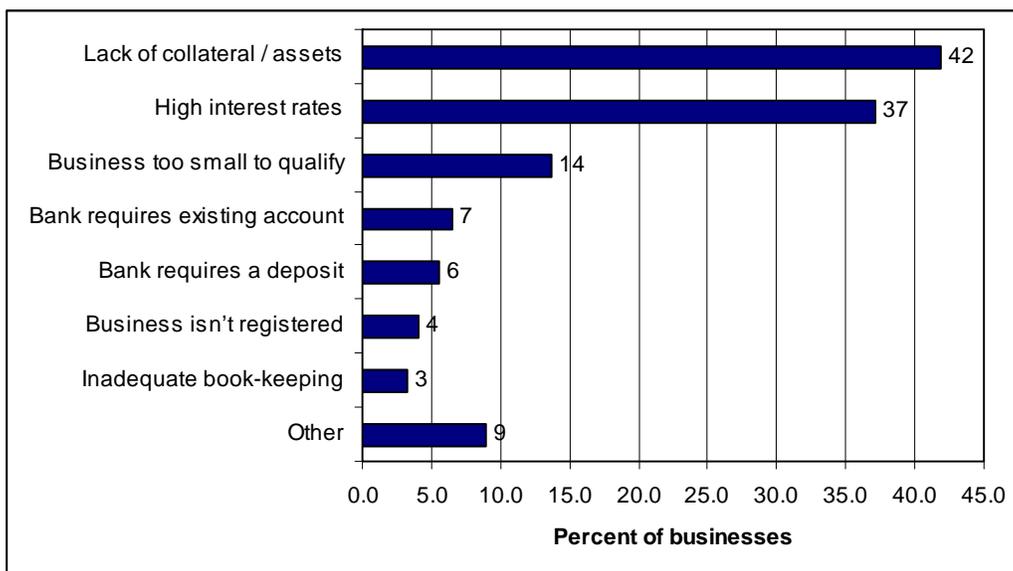
<sup>38</sup> n=602

**Figure 14: Sources of finance<sup>39</sup>**



The most commonly mentioned factors that made it difficult for respondents to access finance from formal institutions included lack of collateral and high interest rates.

**Figure 15: Reasons for experiencing problems accessing finance from formal institution<sup>40</sup>**



Given the limited proportion of SMEs who have successfully accessed finance from a formal institution, and the very high interest rates charged by micro-lenders, it is not surprising to find a number of alternative credit arrangements in operation on an informal basis. Respondents mentioned stokvel and similar arrangements as mechanisms they use to access credit when required.

<sup>39</sup> n = 380

<sup>40</sup> n=129

The difficulty of securing a steady cash flow in order to keep the business sustainable and handle more than one order at a time was raised by several business owners in qualitative interviews.

Almost a quarter of the businesses surveyed (23 percent) noted that they were concerned about the level of debt owed by their businesses.<sup>41</sup> This figure was considerably higher among commercial farmers – almost half of whom (47 percent) expressed concerns about their levels of debt.

#### **Making finance available to SMES**

Challenges facing banks in terms of lending to small businesses include the unstructured nature and poor record-keeping which characterise many small businesses, making it difficult to keep track of spending; the dearth of professional auditing skills; the need for banks to spend time mentoring and tutoring small business clients given the high risk nature of client; the current lack of an active Credit Bureau<sup>42</sup> and difficulties experienced by small businesses in furnishing appropriate collateral.

The commercial banks are currently reviewing different mechanisms to make finance available to smaller businesses. New product offerings include business overdrafts, access to finance against a government contract, business suites which enable small business owners to go straight to a specialised consultant rather than waiting in the general queue, and a staff component dedicated to dealing with small businesses.<sup>43</sup>

#### **7.2.7 Skills shortages and skills transfer**

Shortage of skilled workers was mentioned by 14 percent of respondents in the highest turnover band (M1 million and over), compared to just one percent of the smallest and more survivalist businesses, which tend to be concentrated in the retail and services sectors and have limited skills requirements.

Representatives of a number of large businesses suggested that the government has failed to tap into big business or foreigners working in Lesotho as a positive source of skills transfer. Their perception was that government relies mainly on NGOs to facilitate skills transfer, with limited effect, and has not engaged with big business to find out what skills local industries require. Respondents suggested that the government needs to engage more with big business and to alert trade unions to the potential for job creation and skills development via getting workers (particularly within the textile industry) trained to operate as small suppliers.

Another large business representative noted that, owing to the lack of skills in Lesotho, the company recruits quite a lot in South Africa – both to undertake specific roles and,

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<sup>41</sup> n=584

<sup>42</sup> The Central Bank is in the process of establishing a Credit Bureau

<sup>43</sup> In-depth interview with senior managers at Standard Lesotho Bank, June 2008

in the case of technicians, to facilitate skills transfer. However, the company describes the process of obtaining work permits as a major hassle subject to long delays. According to this respondent, while it used to take two to three weeks to obtain a work permit, it is now taking two to three months.

### **7.2.8 Corruption**

The prevalence of corruption was not specifically probed by the quantitative survey. However, it emerged as a pervasive theme in the qualitative interviews with business people and other key informants. Various examples of corruption that were mentioned included:

- ‘Ghost orders’ – where a business is encouraged by a government official to tender for work that is not in fact delivered, the invoice is then submitted, and the business owner keeps half the amount and the official the other half
- Lack of transparency in tendering and procurement processes, and use of ‘insider’ information by officials
- Bribes paid to officials to get government contracts
- Favours and connections being used to facilitate the buying and selling of land
- Demands from officials that in order to obtain a building permit, the business should use a particular firm to undertake the construction
- Customs officials charging VAT at the border, despite the importer having the receipts to show that VAT has already been paid.

It must be stressed that SBP was in no position to verify any of these allegations.

### **7.2.9 Impact of HIV/AIDS**

The impact of HIV/AIDS on business was not widely acknowledged as an issue by respondents to the quantitative survey. Only twenty-two percent said that they were experiencing some impact as a result of the disease. Even so, two thirds of these firms reported “little impact”, while 7 percent reported a very large impact.<sup>44</sup> Analysis of responses by size of business showed that larger enterprises report a larger impact as a result of HIV/AIDS.

Among those businesses who reported that HIV/AIDS had a large or very large impact on their business, the primary concern was illness and death among customers – reducing an already limited market for goods and services (65 percent of the sub-sample responses). Fourteen percent said that the ill health of their employees was a key reason for the large impact of HIV/AIDS on their business.<sup>45</sup>

Qualitative discussions with businesses noted that the economic impact of HIV/AIDS on households has seen a marked decline in spending power among customers. Many households are supporting relatives infected with HIV, or the children of HIV parents, and household budgets are greatly over-stretched.

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<sup>44</sup> n=603

<sup>45</sup> n=82

The impact on employees includes staff absences owing to the illness, and higher staff turnover, which requires more money to be spent on training of new staff.

The impact on the insurance industry was noted by one respondent. The industry has had to put restrictions on the value of life cover in order to shield itself from financial losses. If a person wants to purchase life insurance to a higher value, they are required to take an HIV test. According to the respondent, people end up not buying insurance because they don't want to know their HIV status.

The GoL is seen to be doing positive work in the areas of HIV/AIDS education and voluntary testing.

### 7.3 Regulatory constraints

Contrary to expectations, regulatory constraints did not feature as a key issue for many businesses.

The informal and survivalist nature of many of the businesses in the sample, coupled with the strong emphasis on key concerns such as market access and competition, saw very few respondents raising regulatory concerns. Forty-two percent of respondents said they did not know enough about regulations to comment on whether they find particular government regulations troublesome or difficult to comply with.<sup>46</sup>

Businesses that did respond tended to suggest that regulations favour big business and foreign business at the expense of the SME sector (seven percent of respondents). At the most obvious level, this perception is understandable because the costs of buying-in professional services to deal with complicated or time-consuming regulation impacts more heavily on small businesses than bigger businesses, while small business owners can ill afford the time to handle regulatory process personally.<sup>47</sup>

#### 7.3.1 Administrative inefficiencies in business licensing

Six percent of respondents complained about processes associated with initial business licensing. A number of respondents suggested that first time applications can take a very long time to be processed. While the **one stop shop** (OSS) has made the process of obtaining trade licenses somewhat easier, it remains a 'handling centre.' Authority still rests higher up in the MTICM, and any issues that arise in the licensing process still have to be referred to the Ministry.

For the small proportion of the sample represented by companies (rather than sole proprietors), the **company registration** process was generally perceived to be fairly

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<sup>46</sup> By the same token, as and when business growth occurs in the SME sector, regulatory issues are likely to become more prominent unless they are addressed proactively.

<sup>47</sup> Internationally, the regressive impact of regulatory compliance costs has been confirmed by various studies, including SBP's own research in South Africa and Rwanda.

easy. It appears that much of the work is done by lawyers, who draft the required memorandum of association and deal directly with the Law Office on behalf of the business. The businesses themselves appear to be relatively uninvolved in the process. The process can however be quite lengthy (taking between two and eight weeks according to respondents), and the lawyers' fees are fairly costly (amounts of approximately M1 500 were mentioned by some respondents). While small businesses in theory could manage the process without contracting lawyers, respondents noted that the drafting of the memorandum is a technical process. They also noted that if the business tried to register without the help of lawyers, the business owner himself would need to go and purchase the necessary legal documents and go to different offices to have things verified, which would be a cumbersome process.

A small proportion of respondents complained about the time it takes to stand in queues and collect all the necessary documentation to meet regulatory requirements more generally.

#### **Standing in queues when you could be running your business**

One SME owner describes his frustrations as follows: "There are a lot of procedures you have to complete in running a business. Most times it needs the owner himself. If there's a document that needs to be submitted somewhere, you have to spend four hours running around from pillar to post. They want it photocopied and stamped and you go to the police station and there's a long queue of frustrated people waiting for the same thing. You are not in your office, so you are not making money at your business."

### **7.3.2 Taxes**

Tax **registration** was generally regarded as problem-free. This entails a visit to the LRA office, where business people present their passport and a copy of the relevant business license, fill in the necessary forms, and after two days receive their tax certificate. Respondents noted that tax inspections are efficient, and tax payments are fairly easy. Businesses may undertake a self-assessment. The LRA's communication with tax payers was generally regarded as effective. Mechanisms include a weekly radio programme about tax issues, print media and leaflet drops, and even text messages sent to individuals' cell phones.

It was noted however that **payments** to the LRA can involve very long queues, particularly at month end. At present there is no provision for electronic payments – business owners need to visit the LRA office in person.

### 7.3.3 Customs and immigration procedures

Delays created by import regulations and inefficient customs procedures were raised by small numbers of survey respondents. Considerable dissatisfaction regarding **customs procedures** was apparent in follow-up qualitative interviews.

An import permit is required for certain goods, mainly food products and machinery. Each kind of item requires a different permit, with different periods of validity. The permit for importing vegetables lasts for a month, for example, but a permit for importing meat, fish or poultry has to be obtained for each consignment. Each permit costs M10. All licenses and permits to import are issued in Maseru. Every time a business brings in a consignment of goods, they have to get their papers stamped in Maseru.

When supplies are imported from South Africa to Lesotho, the goods have to be declared on the South African side of border control for VAT purposes. Some commodities are classified into certain categories, requiring considerable time to be spent at the border filling in particular forms for the purposes of the South African Revenue Services. The invoices then need to be stamped on the Lesotho side of the border, so that VAT can be collected by the Lesotho government.

Some products are zero rated for tax in South Africa, but not in Lesotho. When these supplies (for example cooking oil) are brought into the country, tax has to be paid to the Lesotho tax officials at the border.

Several respondents said that accessing VAT refunds from SARS was very difficult. VAT is charged in South Africa, but the business person does not always receive the paperwork/receipts required to enable them to claim VAT back. If the paperwork is missing, the person bringing goods in from South Africa may have to pay VAT again to SARS at the border.

Both the South African and Lesotho systems are paper-based – crossing the border involves having a wad of paper stamped, causing considerable delays.

Business owners noted that it often takes several hours to get goods through customs. Every hour spent by the delivery truck waiting at the border is a direct cost to the SME. It was also suggested that officials at the customs posts are not well versed in the regulations, and misinterpretations of regulations can result in long delays. It was noted that supervisors are often not present, making it difficult to resolve misunderstandings.

Business owners said that once goods or equipment has been brought into Lesotho, it is very difficult to take them out again for repairs. This process requires the business owner to fill in certain forms on the Lesotho side of the border, then declare the equipment on the South African side, and pay a sum of money as a guarantee that he'll be bringing the goods back to Lesotho. The cumbersome nature of this process, according to respondents, makes it much easier to pay for the technician to travel to Lesotho and fix the problem on site.

The GoL is aware of the long delays involved in clearing goods at customs, and SARS and the LRA are apparently working together to try to improve this.

#### **Administrative inefficiency is a turn-off for tourists**

Delays at the border cause frustration not only to business owners, but also to potential tourists visiting the country. Border posts, on both sides of the border, lack clear signage. While immigration procedures on the Lesotho side are generally quite efficient, long delays at passport control on the South African side, particularly at Maseru Bridge, have become very marked, particularly in recent months – leaving tourists standing in queues for up to an hour for the straightforward clearance of a South African passport.

#### **7.3.4 Property rights and land tenure**

The King as Head of State is vested with the responsibility of allocating land. Land is allocated by Village Development Councils in rural areas, and by committees appointed by the Minister of Local Government in urban areas. Lease titles for commercial and industrial land are valid for 60 years.

In rural areas, land users lack formal title to their land and are thus unable to provide the collateral necessary to secure credit from commercial banks. In the main urban centres, the property lease (which is issued by a professional surveyor) may be used as collateral.

In addition to difficulties associated with securing loans, the difficulties associated with secure land tenure and land transfers limit businesses' ability to purchase land for development.

The transfer of property title through the Deeds Office appears to be very slow. Property on which to build is hard to come by, and very expensive, at least partly as a result of the lack of supply.

While land reform has been on the government's agenda for many years, progress remains slow. It is hoped that a bill on land reform will be drafted by the end of August 2008. In addition, the Department of Land Surveys and Physical Planning is currently establishing an independent Land Administration Authority.

#### **7.4 Perceptions and sources of BDS**

The Lesotho economy is characterised by weak demand for business development services (BDS).<sup>48</sup> BDS on offer are not very differentiated and tend to be generic and

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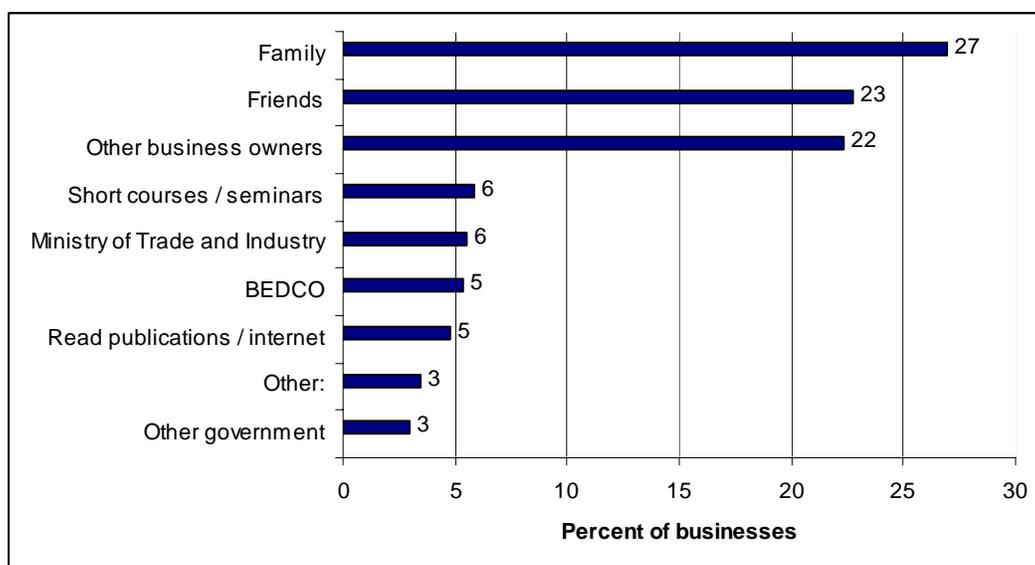
<sup>48</sup> *Capacity Building Plan for the Private Sector in Lesotho*, Ministry of Finance and Development Planning, ECI Africa Consulting, March 2006. The capacity action plan aims to

non-customised. The 2006 *Capacity Building Plan for the Private Sector in Lesotho* noted that while businesses in Lesotho consumed some traditional BDS such as finance and accounting, they currently made little use of services that would address major constraints blocking business growth, which could be summed up as a failure to understand and capture market opportunities.

This observation was borne out by the present study. The survey found that family, friends and other business owners are the most frequently drawn on source of advice on running or starting a business, particularly for smaller businesses.

Only 14 percent of businesses said that they had received advice or support from government bodies, which included MTICM, BEDCO and LNDC.

**Figure 16: Source of advice obtained on starting or running the business<sup>49</sup>**



Sources of advice did not show any significant variation across Livelihood Zones – suggesting that businesses in Maseru with ready access to national government departments and the one stop shop do not necessarily make greater use of these resources than businesses in areas further afield.

Fifty-eight percent of businesses said that they had never accessed any BDS, while 42 percent had used at least one such service. Management training, book-keeping/financial management, and specialized training were the most commonly accessed forms of BDS – mentioned by over half the sub-sample that had accessed BDS.<sup>50</sup>

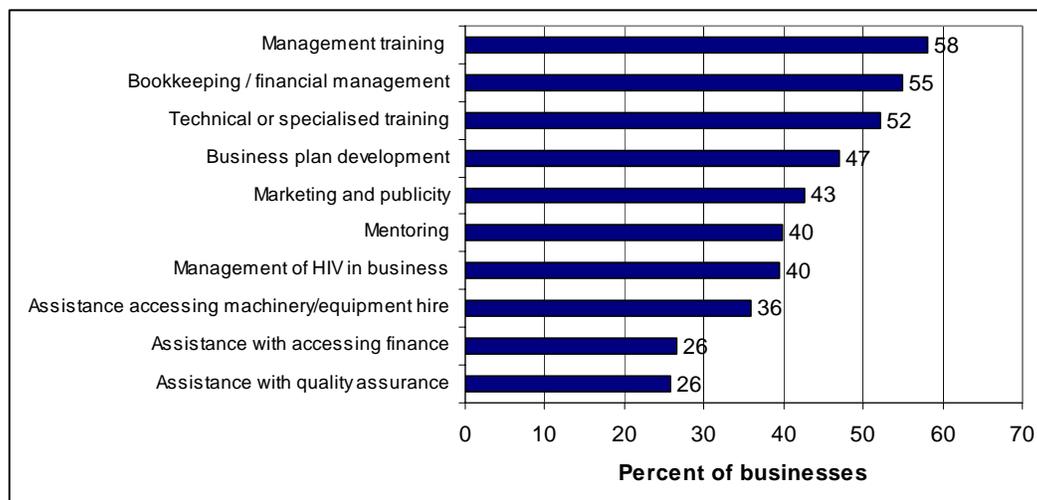
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target sectors with demonstrated growth potential, facilitate market driven demand for capacity building services, and facilitate private sector provision of appropriate BDS, using local firms in conjunction with international providers

<sup>49</sup> n=604

<sup>50</sup> n=253

**Figure 17: Percentage of businesses that have used BDS by type of BDS used**



Respondents said that a lack of knowledge or information about the services was the key barrier to accessing BDS (almost 60 percent of respondents). The second most common response (although accounting for only 13 percent of responses) was simply that the business felt no need of BDS. Ten percent of respondents said they were too busy to access such services, while 5 percent assumed that the services would not be appropriate for their particular needs.

### **7.5 Priorities for government support**

Respondents were asked to specify “the most useful thing” that government could do in order to improve the environment for small businesses.

**Access to finance** was mentioned by 29 percent of businesses in the sample, and was by far the most frequently mentioned area in which businesses would like assistance.

Improved **access to reliable infrastructure** was the second most frequently mentioned issue, and included access to electricity and water (13 percent of respondents). Infrastructure was particularly prioritised by businesses in more remote locations, such as Quthing and Mokhotlong, where it was mentioned by over 20 percent of respondents (compared to only seven percent of respondents in Maseru).

Thirteen percent of respondents wanted the government to provide **premises and facilities for market-places** that could be used by small businesses – this response was particularly prevalent among small retailers.

Other areas of support mentioned by respondents included **improved access to technology or equipment** for the business, including tools and capital goods (22 percent of respondents), **regulatory reform** in the area of VAT administration and customs procedures (ten percent of respondents) and greater access to, and transparency in the issuing of, **government tenders** (nine percent of respondents).

Small numbers of respondents asked for support in terms of **training** for small businesses, and also for **market information** for SMEs to enable them to differentiate their products and identify market gaps.

## 8. Analysis

### 8.1 The policy context

In the period since the *White Paper on small business development* was drafted in 2002, a range of studies and donor programmes have been undertaken with a bearing on SME development<sup>51</sup>. There have also been some significant practical developments initiated by the GoL, including the Gender and Development Policy which addresses the legal status of women, the establishment of the One Stop Shop which aims to streamline regulatory procedures for businesses, and the anticipated establishment of a Credit Bureau.

Important policy initiatives currently under development, such as the *Draft Growth Strategy* and the *IPRGS* focus on integrated approaches to economic development. The *Draft Growth Strategy* reinforces some of the key themes of the *White Paper*, and presents a comprehensive picture of key barriers to growth and approaches to address these.

Lesotho's *Vision 2020* strategy aims to develop a strong industrial base, supported by a thriving small business sector and tourism industry.

While these policy developments are encouraging, it must be emphasised that efforts to build a growth-oriented, value-add SME sector require an *evolution* of approaches over a period of time. There is no magic quick fix.

Research and experience on a global level have resulted in a broad consensus about what has supported sustained economic growth in the past and what is likely to create favourable conditions for future growth. Key 'ingredients' include:

- Strong and stable government and disciplined macroeconomic management
- Effective political, legal and market institutions that guarantee the rule of law, protect private property rights and ensure enforceability of contracts
- The effective operation of markets, pursuit of comparative advantage and accumulation of capital, all of which drive increases in incomes per head
- Division and specialisation of labour
- Technological, managerial, and institutional advances that increase efficiency
- A supportive regulatory environment
- Appropriate incentives for entrepreneurs to take risks and expand their businesses.

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<sup>51</sup> See Annex 1: *Overview of Relevant Studies and Initiatives*

The processes of getting these conditions in place, and creating a culture and environment that encourages entrepreneurs to make the most of them, takes a long time, and the relative importance of different aspects of the mix will rise and fall.

This section reviews some of the key issues impacting on SME development in Lesotho. Many of these issues were identified in the *Draft White Paper* in 2002 – the critical importance of addressing them effectively has not diminished in the past few years.

## **8.2 Market opportunities**

### **8.2.1 Limited business linkages in the context of a ‘missing middle’**

Many developing economies, particularly those in sub-Saharan Africa, suffer from a ‘missing middle.’ Lesotho is no exception. The term refers to the lack of a core of growth-oriented small and medium businesses that, in a fully developed economy, fill the space between large firms on one hand and micro-enterprises and survivalist and informal sector businesses on the other.

Locally-owned and growth-oriented SMEs are a crucial component of private sector growth and development. They act as sub-contractors to locally-owned and foreign-owned larger firms, and play an important role in developing locally based supply chains. A shortage of these SMEs requires big businesses to source their inputs and supplies from other countries, or from one another. This practice limits the integration of foreign-owned businesses in the local economy, and restricts the multiplier and spill-over benefits of big business activities for the local economy. This can create significant tensions with local communities – which are clearly apparent in the strong levels of resentment expressed by many interview respondents toward Chinese-owned businesses in Lesotho.

In 2002 the *Draft White Paper* highlighted the absence of backward linkages (purchase of raw materials and other inputs) between the foreign-owned garment manufacturers and indigenous small business in Lesotho, and noted that large garment producers have neither a mandate nor incentives to pursue local linkages. Various policy documents over the past six years have emphasised the importance of improving integration between the supply chains of large foreign firms and domestic SMEs.<sup>52</sup> The Capacity Building Plan for the private sector in Lesotho (2006) identifies major weaknesses in the private sector’s ability to identify and capture opportunities to sell to large foreign companies, regional markets and government.<sup>53</sup>

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<sup>52</sup> The Formulation of a PSD Strategy (2004); Value Chain Analysis of selected strategic sectors in Lesotho, Global Development Solutions (2004), The Capacity Building Plan for the private sector in Lesotho (2006), the Private Sector Competitiveness and Economic diversification Project (2007); The Interim Poverty Reduction and Growth Strategy Paper 2008/09

<sup>53</sup> Ministry of Finance and Development Planning, ECI Africa Consulting, March 2006

Export-oriented investors import most of their inputs, and as a result have very limited investment in the local economy. The textile and apparel industry provides a stark example. The industry accounts for 20 percent of Lesotho's GDP and nearly 50 percent of the formally employed workforce. Nearly all Lesotho's apparel products are exported. The sector however is largely limited to simple cut, make and trim operations. Preproduction operations such as fabric sourcing, sample and pattern making are carried out by agents in Asian countries, and local capacity to undertake finishing is limited. Local small-scale garment-makers have little opportunity to interact with possible suppliers, or to make direct contact with potential retailers.<sup>54</sup>

Similarly, many of Lesotho's big retailers are South African owned, with procurement offices in South Africa - making it very difficult for local small businesses to become suppliers to them.

The upshot of this is that larger, export-orientated firms in Lesotho have had limited positive impacts on local economies. The developmental impact of foreign investment – including wealth creation, employment opportunities, and improved local capacity – is very limited. Foreign firms tend to be perceived by small businesses as overwhelming competitors rather than as potential sources of business.

The importance of this issue in the context of private sector growth must not be underestimated. Foreign investment in the country is extremely positive at present. The IPRGS notes that the LNDC was involved in 41 new project negotiations as at March 2007. Of these, 14 were definite commitments to invest in Lesotho between 2007 and 2008, and six were expansions of existing industries. The IPRGS also notes a recent announcement by Dutch company Philips Electronics that it will be building a major new plant to produce 15 million compact fluorescent light bulbs per annum, which are destined primarily for the South African market. The key challenge is to channel this into sustainable, broadly beneficial development.

### **8.2.2 Barriers to linkages**

Larger businesses operating in Lesotho identify two main obstacles that stop them making greater use of local small businesses in their supply chains:

- Small businesses have limited understanding of the needs of big businesses, and how and where they can tap in to their supply chains and take advantage of new market opportunities
- Local suppliers have limited capacity to meet the quality standards of the export market, are unable to produce at scale, and cannot be relied upon to deliver consistently in the quantities and timeframes required.

It appears that Lesotho's policy and regulatory framework has also contributed to the problem. A 2004 study noted that in the garments sector, local sourcing initiatives are

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<sup>54</sup> Market diversification of the Lesotho Garment Industry, April 2006, FIAS

discouraged by government policies such as the imposition of VAT on foreign investors and the slow rate of VAT refunds.<sup>55</sup>

### **8.2.3 Implications for GoL**

Given currently limited SME capacity to provide the quantity and quality required to reach the export market, it would be useful to focus in the short term mainly on facilitating improved access for SMEs to the domestic market.

LNDC and BEDCO should share responsibility for supporting the development of well-capacitated, growth-oriented SMEs to populate the 'missing middle' and take advantage of linkage opportunities. Clear roles should be assigned to each organisation, to ensure that information flows between large and small business are improved in order to promote better integration of supply chains.

### **8.3 Institutional allocation of responsibility for SME support**

The *White Paper on small business development* emphasised the importance of viewing small businesses as a continuum, from informal and survivalist enterprises on one end, through to growth oriented and medium sized businesses on the other. This perspective is important in the context of developing supply chains and encouraging linkages, given the need to build interconnections between different levels of SMEs, as opposed to developing policies with a limited focus on micro-businesses. It is also important in terms of supporting SMEs to move up (and down) the scale.

The extent to which this continuum is recognised in government approaches and institutions needs improvement. The existing implementing structure for SME development is characterised by overlapping areas of concern and blurred responsibilities among MTICM, Ministry of Finance and Development Planning, LNDC and BEDCO. There is a lack of clarity regarding the roles of each institution. Relationships between the institutions appear to be characterised by poor communication.

Qualitative interviews pointed to perceived friction between BEDCO, LNDC and the MTICM as undermining government efforts to promote SMEs. The agencies were criticised for failing to communicate with each other. Some respondents suggested that the BEDCO is under-funded by the government. It was also suggested that MTICM does not keep BEDCO informed, which undermines BEDCO's effectiveness.

Small business support is seen to be predominantly BEDCO's responsibility – an organisation which SMEs describe as under-capacitated and failing to deliver. BEDCO is also described by SMEs as focusing its support efforts primarily on micro-enterprises such as rural handicrafts – leaving SMEs seeking real growth opportunities frustrated.

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<sup>55</sup> Value Chain analysis of selected strategic sectors in Lesotho, Global Development Solutions, 2004

Representatives of large businesses suggested that while the LNDC does good work in the field of foreign direct investment, the agency's efforts to promote and create linkages with local businesses are limited.

SMEs suggested that SMEs with a strong growth focus should have better access to LNDC, which is perceived as a possible route to accessing broader market opportunities. There is a perception among SMEs that LNDC works only with foreign-owned large firms.

The fact that SMEs are poorly equipped to identify and access information about market opportunities, competitive products and services, and the procurement requirements of potential suppliers, is at least in part a problem of poor working relationships between BEDCO and LNDC.

### **8.3.1 Implications for GoL**

It is important to recognise very clearly that SME development needs to be integrated into Lesotho's broader growth strategy, and that efforts to encourage foreign investment and support for larger firms (key priorities for LNDC) should as far as possible be coupled with initiatives to develop vertical links within the economy and support local businesses to tap into new opportunities as a result of foreign investment.

This requires that the roles of MTICM, Ministry of Finance and Development Planning, LNDC and BEDCO in respect of SME development are clearly defined and accepted by these institutions. Responsibilities across the institutions should be functionally differentiated as far as possible while being mutually reinforcing, in the spirit of the White Paper. Policies and processes aimed at supporting SME development need to incorporate mechanisms for LNDC and BEDCO to work together to identify opportunities for SMEs to be integrated into broader supply chains – *not* treated as a stand-alone category.

A fundamental requirement is to improve SMEs' access to information on potential suppliers and purchasers. The LNDC and BEDCO need to work together to improve SMEs' ability to identify and access market opportunities. This requires easy access to information about procurement procedures and requirements. A useful approach is to facilitate interactions between SMEs and big business, providing an opportunity for large corporations to meet with several SMEs at a time to present their procurement policies and procedures and highlight requirements for tendering businesses. This engagement also provides large businesses with an insight into the specific hurdles that SMEs face in winning contracts with their companies, and can provide a useful forum in which to explore possible solutions.<sup>56</sup>

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<sup>56</sup> SBP has facilitated successful forums of this type in South Africa, Tanzania and Malawi, as components of its Private Sector Initiative (Psi) projects

### **Bridging the information gap between large and small firms**

Large companies often find it difficult to identify small businesses with products and services relevant to their supply chains. When SMEs approach them, it is difficult to assess their qualifications and experience cost-effectively. Visits to individual SMEs are expensive and time-consuming. As a result, when the number or value of transactions is relatively small, efforts to identify reliable small suppliers are likely to be very costly in relation to their possible benefits. One way to address this problem, which has worked very successfully in Malawi, is to work with large and small firms to develop a shared supplier database – which allows participating companies to identify, rank and accredit SMEs. SMEs apply to be included on the database, companies review the services on offer, and, having worked with a particular SME, go back to the database and rank the SME's delivery. This process enables companies to collaborate cost-effectively and at a large scale – reducing duplication of effort and facilitating learning from experience across members. The system also helps to identify synergies among companies' existing local supplier development programmes. SMEs benefit too – those that perform well build up a strong reputation and effectively receive free marketing through the database.

#### **8.4 GoL procurement practices**

Improved access to government contracts represents a key mechanism to integrate SMEs into local supply chains and develop their capacity to fulfil the procurement requirements of larger businesses.

The *White Paper* noted that the public procurement system discriminated against indigenous small businesses (by subjecting them to more stringent proof of regulatory compliance than foreign firms) and that slow payment of suppliers by government departments was rife. Interviews undertaken with a range of SMEs during the course of the project indicate that six years on, problems persist.

SMEs express a strong perception that the government tends not to use local small businesses as suppliers. Payment times do not appear to have improved. Late payment creates enormous cash flow problems for small businesses, many of whom are unable to access credit, and seriously jeopardises their ability to take on other orders.

While the GoL has recently decentralised procurement to Ministry level, the implications for SME access to the supply chain remain to be seen.<sup>57</sup> The establishment of the PPAD (Public Procurement Advice Division, MoF), which sets policy and establishes regulations and procedures to be followed in the ministries, conducts spot checks on compliance and hears appeals, is relatively recent, and it is too soon to judge its implications for SMEs.

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<sup>57</sup> It was suggested by some stakeholders that the new system enables line ministry officials to misuse insider-information to influence the tendering process.

It is encouraging to note that an active training programme for officials in ministries and districts has been developed at the initiative of the Private Sector Development and Financial Affairs Department (MoF) in conjunction with the Chartered Institute of Purchasing and Supply (UK) and the Institute of Development Management. By 2009 the programme, which will offer training at various levels (certification, diplomas and degrees) should be producing professionals qualified in supply chain management. Potentially this is a powerful tool for local economic growth and the indigenisation of the supply chain in and through public procurement. However, an attendant risk may be that if public sector salaries are not sufficiently competitive, trained personnel could be lost to the private sector, parastatals, and international organisations.

#### **8.4.1 Implications for GoL**

It will be important to review the extent to which initiatives aimed at improving procurement practices in government are able to support and mainstream mechanisms to strengthen the role of small business in the supply chain.

Such a review must take into account the logistical challenges faced by small firms, including the time required to access inputs outside the country, and the need buy inputs in advance, generally with cash, on a very limited budget. These problems can be solved at least in part by advertising procurement opportunities in good time, lengthening delivery time-frames and ensuring that small businesses get paid on time. Government departments can also minimise their risk by engaging new suppliers on the basis of fairly small contracts in the initial instance, giving them an opportunity to test their capability and commitment to deliver.

Effective and targeted communication of tender opportunities to SMEs, particularly in respect of tenders under a specified threshold amount, is also an important mechanism to improve access.

The GoL's efforts to improve SME access to GoL procurement opportunities need to be coupled with review of payment periods. The GoL may wish to make a firm commitment, applicable to all government departments and agencies that SMEs undertaking work for the public sector will be paid within a specified period – with penalties for departments that fail to comply.

#### **Speeding up payment by government departments**

Late payment by government has long been a problem for small businesses in South Africa. South African legislation mandates government departments to pay small businesses within 30 days. The South African Department of Trade and Industry has set up a call centre dedicated to dealing with complaints from business owners who have not been paid on time for work done for government departments and municipalities. In Gauteng, the Provincial Government has gone even further, and has committed itself to ensuring that that micro and small suppliers are paid within 15 days following receipt of all the relevant documentation.

## 8.5 Forums for business collaboration

Business owners interviewed for the study suggested that a lack of business unity and institutional support, such as well functioning businesses associations, hampers small businesses' ability to mobilise and lobby for support. Qualitative interviews revealed both apathy and frustration regarding the existing business associations to which small businesses can potentially belong.

Organised business in Lesotho is currently represented by two main chambers. While government understandably would prefer business to speak with one voice, it is also advisable to listen to the different voices that articulate different but equally legitimate interests and concerns.

The **LCCI** is the long-established voice of business in Lesotho (it has been in existence for some 40 years). It aims to provide a forum in which business people are able share ideas, network and influence local trade conditions, as well as occasionally providing training for members.

The **Mohloli Chamber of Business** is a new player. It was legally registered in 2005. Mohloli has made 'smart partnerships' – including partnerships with government – a prominent feature of its agenda, recognising that government spending can be a strong tool in national economic development through local procurement. MCOB believes that it is important to strengthen awareness and practice of corporate governance in Basotho businesses (noting that personal and business issues are too often "intertwined") as well as to provide training in business planning and administration.

The **Lesotho Business Council** is a new structure, recently established as an umbrella organisation for business, and as the official vehicle for business-government engagement. It is jointly chaired by a senior private sector representative, and a senior representative of the GoL. While it is too soon to assess its effectiveness, questions have been raised about its dynamism and the effectiveness of its connections upward and downward into the business community. It appears that the Council has met infrequently and irregularly.

The extent to which SMEs are adequately represented or supported by any of these institutions appears to be limited, however. During qualitative interviews, several respondents noted the lack of institutional support, and a unified voice for small business, as a key concern. A number of individuals suggested Basotho SMEs tend to "struggle along individually rather than pull together." It was suggested that this has contributed to the limited growth prospects and profitability of small businesses.

### **SMEs must recognise shared interests**

Respondents suggested that high levels of distrust and competition among SMEs undermine their ability to respond to shared challenges: “We have a problem as Basotho really, we don’t know how to meet and discuss a common issue. Others always pull in the opposite direction. Most of the things we want to achieve will not materialise because we are always fighting amongst ourselves”.

The lack of strong forums in which SMEs can effectively engage contributes to the absence of effective business linkages. One of the key constraints to effective SME participation in value chains is the high transaction costs incurred by larger firms if they have to interact with a large number of small firms individually in order to obtain sufficient quantity of product.

Several small business owners bemoaned the lack of sector-specific umbrella organisations, which could provide a mechanism to address sector-specific problems on a collective basis. It was noted that insurance brokers have been investigating the establishment of such a body, but that owing to limited understanding of the mechanisms involved, together with some apathy within the sub-sector itself, there has been little progress in this regard. Small clothing manufacturers and dressmakers suggested that their businesses would benefit from the creation of a Clothing Institute, which would enable them to communicate within the sector and lobby manufacturers for better deals.

#### **8.5.1 Implications for GoL**

The Private Sector Competitiveness and Economic Diversification Project (2007) aims to provide support for business associations. Initiatives under this programme should aim to accommodate the particular needs of SMEs.

BEDCO could play a key role in facilitating the development of sector-specific clusters or associations. If small businesses are organised into effective associations, they are in a much better position to:

- Negotiate market opportunities
- Combine purchasing power and make shared arrangements around transportation, thus reducing costs and accessing discounts for bulk buying
- Collaborate to produce at scale, making it easier for them to supply in appropriate quantities for big business and access supply chain opportunities.

## **8.6 Socio-cultural barriers to entrepreneurship**

The IPRGS identifies a lack of entrepreneurial and technical skills as a key constraint to SME development. However, it also presents SME development as a response to *welfare* policy, stating that the government of Lesotho is “committed to increase support to SMEs that people are increasingly starting as alternative livelihood strategies in the face of a lack of formal wage employment.”

The latter statement is highly problematic. The tendency to view small businesses as micro-enterprises established for survivalist purposes can only undermine their potential. Small business growth and development needs clear recognition from policy makers of the value of entrepreneurship and the potential for SMEs to drive economic growth and job creation. The Lesotho government needs to ensure that its policy statements – and interventions – are strongly based on the premise of growth orientation and job creation in the small business sector. Government departments and agencies with a mandate for economic development need to demonstrate recognition of the value of entrepreneurship. This is central to achieving the IPRGS’ stated objective that, to mitigate the risks of reduced remittances from migrant workers and threats to revenue receipts from SACU, there is an urgent need to explore ways to increase domestically generated income and shift to a faster, more broadly based economic growth path.

Equally, Basotho in employment need to be persuaded of the potential of establishing their own small businesses. Interviews with big businesses in Lesotho revealed an appetite among some larger businesses to grow employees as entrepreneurs who could potentially establish their own small businesses, and supply their former companies with key services that could easily be outsourced. This approach to the localisation and indigenisation of the supply chain through the creation of business linkages has worked successfully as an element in SBP’s linkages programmes (the “Private Sector Initiative”) in South Africa and Tanzania. It decreases direct costs for the larger companies, and provides an opportunity to outsource parts of the production process and pass on smaller and less profitable orders.

The perception among big businesses in Lesotho, however, is that employees lack the appetite to make the change, and are sceptical about the viability of running their own small business. A number of big business representatives suggested that the government should be doing much more to use big business as a vehicle for skills development, and to support a more entrepreneurial culture across the workforce.

### **8.6.1 Implications for GoL**

Developing well-equipped business owners, with the capacity and vision to grow their small businesses into job-creating enterprises, needs to go well beyond skills training. Efforts to encourage the development of a culture that recognises and values entrepreneurship should include targeted policy initiatives that aim to grow young entrepreneurs and expand the horizons of existing businesses.

Such initiatives could be actively supported by the proposed Lesotho Skills Agency and its sector skills committees. Initiatives could include a range of business exposure programmes and internships, competitively-based and targeted at different cohorts. School children for example could be encouraged to participate in competitions for business start-up plans or other entrepreneurial activities. School-leavers and students could compete for internships in large companies (including South African companies) in order to expose them to a range of possible market opportunities, or for short-term visits abroad to experience dynamic SME activity.

Simple awareness-raising campaigns, such as a well-publicised national annual SMME award and/or young entrepreneur award, can also have a very positive impact. Such programmes provide exposure and free marketing for successful SMEs, with a persuasive demonstration effect of the potential for SMEs to develop competitive advantage.

Facilitated peer networking programmes among SMEs offer another useful approach. Such programmes have shown considerable success in helping to build capacity and support the development of business relationships and knowledge sharing among SMEs.<sup>58</sup> SMEs network with and learn from their peers, and provide mentoring, capacity and confidence-building support to one another. They also share area-specific information on administrative and logistical issues and emerging opportunities.

## **8.7 Infrastructural challenges**

Lesotho has no shortage of studies highlighting the need for improving access to physical infrastructure as a key component of the promotion of business growth. The extent to which infrastructural challenges limit market access and production capacity for SMEs was also demonstrated by the survey results.

Under-developed transport infrastructure limits the accessibility of many areas, and Lesotho's road infrastructure remains largely unpaved. The 2006 Transport Sector Policy and the Transport Sector Programme aim to provide an enabling environment for efficient, cost effective and safe transport. Constraints include limited government resources, limited capacity in local road construction in the private sector, and the high cost per capita for provision of transport infrastructure in sparsely populated areas.

Other infrastructural problems include a lack of identified and designated industrial locations to enable the development of serviced premises for industry, in the context of a severe shortage of factory shells. This results in high rentals for SMEs, particularly in the larger urban areas, where they face a limited range of options in selecting a suitable location for their business.

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<sup>58</sup> For example SBP's Business Bridge model for SME peer networking has been successfully implemented in South Africa and Malawi. But it should be noted that this model works best in groups comprising a mixture of business people from different sectors, rather than direct competitors.

It is clear from the *Draft Growth Strategy Paper* and other policy documents that the GoL has made a firm commitment to the development and maintenance of reliable physical and communications infrastructure.

Improved electricity, water and road infrastructure is of critical importance for SMEs– in terms of expanding capacity and opportunities for domestic and external trade, as well as stimulating the development of the country’s tourism industry.

### **8.7.1 Implications for GoL**

The *Growth Strategy Paper* recognises that new infrastructure developments are often commissioned on an ad hoc basis, with targets defined within individual ministries and inadequate coordination across government. It will be important for all relevant government departments and agencies to take ownership of the *Growth Strategy Paper’s* Minimum Infrastructure Platform, and ensure that the planning and implementation of physical and communication infrastructure developments are coordinated across departments and sensitive to SMEs’ market access and production needs across different locations.

Creative approaches to address the shortage of serviced premises for businesses (which translates into high rentals and limited opportunities for business expansion) need to be explored. Options may include review of regulations governing property zoning and transfer of tenure. Consideration should also be given to establishing BEDCO sites as managed workspaces outsourced to the private sector.

## **8.8 Access to finance**

A difficulty common to small businesses in many economies is that of access to finance. In Lesotho, the issue has been highlighted by a broad range of policy documents and studies, from the *White Paper* to the current *Growth Strategy Paper*.<sup>59</sup> The survey results confirm that SMEs’ access to loans and overdraft facilities from commercial banks has been extremely limited to date. Many SMEs rely on money lenders and incur exceedingly high interest fees.

The *Growth Strategy Paper* notes that the financial sector is relatively small, and local banks have played a minimal role in financing economic growth in the country. The financial sector is characterised by the presence of a few large foreign owned banks, many small foreign majority shareholding insurance companies, and numerous small money lenders. Only about 38 percent of household heads in Lesotho have access to banking and these are predominantly in the core urban areas.

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<sup>59</sup> White Paper on small business development (2002); World Bank Assessment of the Investment Climate (2006); Value Chain Analysis of selected strategic sectors in Lesotho, Global Development Solutions (2004); the Millennium Challenge Compact (2007); the Capacity Building Plan for the private sector in Lesotho (2006); the Private Sector Competitiveness and Economic diversification Project (2007); the Interim Poverty Reduction and Growth Strategy Paper 2008/09

The GoL is engaged in a number of programmes designed to improve access to finance for small businesses, particularly those in rural areas. The commercial banks are also reviewing their product offerings in this regard.

The GoL is currently in the process of establishing a Credit Bureau, assisted by the MCA. The MCA is also helping the government to strengthen payment and settlement systems in order to reduce transaction costs and increase access to financial services. Representatives of commercial banks in Lesotho welcome the introduction of the Credit Bureau, and are optimistic that it will be very useful in extending the range of small businesses that are able to access bank loans and overdrafts.

The Rural Finance Intermediation Programme, part of IFAD, is working with Lesotho's Post Bank to enable the Bank, currently restricted to offering savings facilities, to gain the legal status required to allow it to become a credit provider. The Post Bank has a far wider distribution of branches than the commercial banks and as such is in a good position to extend finance and saving mechanisms to rural households. It is also a familiar institution for businesses in Lesotho, and is likely to be more attractive to rurally based small and micro enterprises as a possible source of business finance than a commercial bank.

IFAD is simultaneously working with the Central Bank's Rural Finance division to improve its capacity to extend finance and improve savings behaviours among the rural poor. IFAD is training division staff to understand rural finance needs better, and assisting with a review of legislation regulating financial institutions.

Other initiatives under the Rural Finance Intermediation Programme, which reports to the Department of Private Sector Development and Financial Affairs in the MOF, include:

- Development of member-based financial institutions
- Capacity building of financial cooperatives
- Capacity building of rotating saving and credit groups
- Capacity building of informal financial groups
- Facilitating rural outreach of formal financial institutions
- Linkages between commercial banks and financial groups and cooperatives

For growth oriented SMEs, a possible mechanism to improve access to finance is the Partial Credit Guarantee Facility, supported by the LNDC and administered by the Central Bank. Businesses wanting to export will be able to apply for loans from commercial banks. The Central Bank will guarantee fifty percent of the loan if the business can provide proof of a specified volume of orders. The project also aims to provide banks with technical assistance to enable them to evaluate SME proposals appropriately. However, the extent to which the initiative is likely to assist SMEs in its current form was questioned by a number of stakeholders in the financial sector. The perception is that small businesses are unlikely to qualify and would find it difficult to

comply with the associated red tape.<sup>60</sup> It was suggested that the requirements regarding reporting and paperwork need to be relaxed for the scheme to become really effective for SMEs.

A new Leasing Act is being developed with the support of the Private Sector Competitiveness and Economic Diversification Project. This could be a useful development in enabling SMEs to furnish alternative forms of collateral.

The success of these initiatives will rely in part on SMEs themselves improving their book-keeping and auditing practices and working more closely within the rules and regulations of formal credit institutions.

Banking representatives have expressed concern at the dearth of professional auditing skills in the country, and it seems likely that a programme of fairly close mentoring and support will be needed to accompany first time loans.

### **8.8.1 Implications for GoL**

Proposed key areas for further work are:

- Recognition of alternative collateral mechanisms as a mechanism to address the liquidity gap and improve SMEs capacity to respond to large orders. Possible forms of collateral could include capital equipment owned by the SME, and contracts with large businesses secured through business linkages, possibly on a risk-sharing basis with the contracting large firm.
- Effective communication and information dissemination to inform SMEs of new mechanisms through which finance might be accessed (given that the majority of SMEs currently do not perceive the commercial banks as an option for their businesses). Sub-contracting of such communication activities to SME providers in the marketing and communications sector would provide a clear indication of GoL's commitment in this area.
- Collaboration with commercial banks to ensure that SMEs accessing credit for the first time are capacitated to manage the debt, and develop effective book-keeping and reporting mechanisms.

## **8.9 Regulatory and administrative efficiency**

The GoL has introduced a number of initiatives aimed at improving regulatory efficiency. These include:

1. The new One Stop Shop (OSS), based in MTICM's offices in Maseru, where businesses can access a range of services from government ministries. It has four key components, which are being sequentially developed: Facilitation of imports and exports; Business licensing and registration; Immigration and work

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<sup>60</sup> Participants are required to send detailed bi-weekly reports to LNDC, as well as requiring with various regulatory requirements.

permits; and Initiation and servicing of businesses' electricity, water and telecommunications accounts

2. Company registration and licensing reform. A new Companies Bill (due for submission to Cabinet in the second half of 2008) will reduce the number of steps and time required to register a business and obtain the necessary licenses
3. Reform of the immigration and passport service, which includes a pilot project for visa pre-clearance and port of entry visa issuance, and a pilot to partially computerise adjudication and information services within MHAPS as well as operations at selected border controls.

The survey findings point to an SME sector currently dominated by micro-enterprises, largely concentrated in the informal sector, which have little interest in or understanding of regulatory issues.

The primary regulatory hassles experienced by respondents are the licenses and permits required to import supplies, which must be obtained from the office in Maseru, long delays created by inefficient customs procedures on both sides of the border, and the requirement that business owners are physically present to renew licenses and permits (rather than being able to effect such renewals remotely).

There appears to be little incentive to formalise. The opportunity to operate in the formal sector *should* offer small businesses improved access to markets, protection from harassment by officials, and improved opportunities to access suppliers and sources of finance – all of which are important to business growth. However, the survey showed that these benefits are not particularly apparent to businesses in Lesotho's informal sector. This suggests that while a reduction of red tape is important to reduce the difficulties encountered by firms on issues such as licensing and customs, it is also important to raise regulatory quality. Rules and tax regulations need to be enforced consistently and systematically. Formalisation needs to be visibly linked to improved access to public services and opportunities for growth. The best way to reduce the size of the informal sector is to improve the business environment and lower the costs and increase the benefits of doing business in the formal sector. Despite the fact that regulations by definition are largely not observed in the informal sector, an inefficient regulatory system greatly reduces opportunities and incentives for transition to the formal economy.

Regulatory issues are likely to come more sharply into focus as SMEs grow and become engaged in a broader range of activities. The regulatory environment needs to support this growth.

### **8.9.1 Implications for GoL**

A detailed review of the regulatory environment governing SMEs does not appear to be called for at this stage. However, it is clear that administrative inefficiencies cause unnecessary delays and frustrations for small businesses in their interactions at the

government interface (particularly in terms of licensing and customs procedures), and these should be addressed.

Key recommendations for action are as follows:

- The One Stop Shop, which aims to provide SMEs with a streamlined process to fulfil their regulatory requirements, needs to be as user-friendly and proactive as possible. The OSS should be staffed with people who have business experience and are able to relate effectively to the concerns and experiences of their customers. Its efficiency and effectiveness in dealing with clients should be closely monitored and evaluated.
- Growth-oriented SMEs should be encouraged to participate in joint ventures with foreign investors, as a means of maximizing available investment funds and creating opportunities for skills transfer and market diversification. The requirement for all businesses to be majority owned by Basotho should be reviewed, given the possible limitations this imposes on the scale of such joint ventures.
- Entry points into the country should offer a smooth, simple and fast track customs procedure.
- The extent to which VAT regulations and their administration discourage local sourcing should be assessed, and the system modified where necessary.
- The licensing regime should cease to be viewed as a revenue-generating system, and should be restructured to make it primarily an information gathering system, in line with the White Paper's recommendations.
- Information on SME licensing and registration should be collated and shared across GoL departments and agencies, in order to provide a more accurate and comprehensive picture of SME activity in Lesotho. As part of this process, those licensing authorities that have not yet developed electronic databases should be supported to do so.

### **8.10 Skills**

Skills shortages impact negatively on economic growth prospects in Lesotho. This is well documented by previous studies. For example, the PSD Strategy (2004) proposed human capital development as a key component of a Minimum Infrastructure Platform; the Value Chain analysis (2004) identified skills shortages and lack of knowledge transfer as key constraints to the development of business linkages; and the Private Sector Competitiveness and Economic Diversification Project (2007) highlighted the importance of skills development.

While the GoL performs well in terms of public expenditure on education, rates of enrolment at secondary schools are well below the SADC average. Studies have shown that skills-training is not well matched to industry needs, and labour productivity is low.

The draft Technical and Vocational Educational Training (TVET) policy has been developed to address these problems. The policy recommends the introduction of a semi-autonomous Lesotho Skills Agency and sector skills committees within this institution. With support from the World Bank, two industry-led skills development centres, in Maseru and Maputsoe, have been established in the textiles and clothing sector, and are in the process of becoming operational. The *Growth Strategy Paper* supports a more demand led approach with new curricula aligned to the needs of the labour market.

It will be important to ensure that the particular skills sets needed in the SME sector are explicitly provided for in the TVET agenda.

#### **8.10.1 Business linkages offer an effective mechanism for skills development**

The role of big business in informing the GoL about the types of skills needed in different economic sectors, and in actively encouraging skills transfer through business linkages, internships and employee training programmes, needs to be recognised and tapped into. Effective business linkages offer opportunities for small businesses to gain technical skills and support from big businesses, together with sharing of information and on the job training through embedded services.

#### **8.10.2 BDS should *not* be a priority function for the public sector**

International research assessing government-run business development services (BDS) has found that there is no evidence that such services have played a significant role in the improvement of competitiveness.<sup>61</sup>

State-supported BDS reach only a very small proportion of the business population in developed and emerging economies. It has also proved very difficult to maintain quality of service. By contrast, profit-making business services have proved to be one of the fastest growing elements in the private sector in the OECD and in India, where the private sector supplies effective BDS without state support.

Given the large proportion of informal micro-enterprises in the SME sector in Lesotho, the prospects for government-supported BDS achieving a useful scale are very small. Furthermore, a 2005 ILO report, which found evidence of 'extensive provision' by the private sector of BDS services to the poor worldwide, noted that, 'contrary to what has often been assumed in the past, the poor sometimes prefer these services over free-of-charge public provision, as they have more control when they are customers.'<sup>62</sup>

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<sup>61</sup> Bannock G, *The Economics and Management of Small Business, An International Perspective*, London, 2005

<sup>62</sup> International Labour Organization (ILO) 2005 *From BDS to Making Markets Work for the Poor*, Geneva

### **8.10.3 Implications for GoL**

While the TVET policy is a positive step, the GoL should also explore other mechanisms to encourage skills transfer, including internships for promising entrepreneurs (as described in section 8.6) and linkage programmes.

Recognising that BDS for SMEs is currently an under-developed market in Lesotho, it is recommended that BEDCO's role in BDS provision be limited to provision of general information and sign-posting, allowing private sector BDS providers to develop in response to local and/or sector specific needs. As private sector providers become more established, it may be useful for BEDCO to develop a quality monitoring/accreditation function to help ensure the SMEs have access to high quality services.

## **8.11 Regional integration**

In the longer term, given Lesotho's small size and the limited local market for goods and services, the country's most viable opportunities for sustained economic growth come via external trade and closer integration in regional markets.

The Integrated Framework Diagnostic Trade Integration Study (2003) recommended lowering the cost of trading with South Africa and other SACU partners, establishing a competitive business environment, and pursuing regional regulatory cooperation. The study identified a number of mechanisms to support integration, including streamlining of visa regulations, improved physical infrastructure and provision of information on doing business in Lesotho.

The LNDC has identified a number of areas with potential for export, including handicrafts and sandstone, and processed wool and mohair, and is working with individual businesses in these sectors.

The *Growth Strategy Paper* calls for efforts to consolidate current investment in textiles while pursuing a product and market diversification policy, together with pursuit of foreign trade policy that maximises access to foreign markets for Lesotho's exporters. It notes that one of the goals of Lesotho's industrialisation policy is to develop the indigenous private sector through support of Basotho entrepreneurs to invest in export-oriented projects.

The success of this strategy relies on improving SMEs' understanding of international markets, trade practices and policies, SMEs' ability to meet quality standards and quantity requirements, production technology, skills and marketing.

### **8.11.1 Implications for GoL**

Improved interactions between LNDC and BEDCO are necessary in exposing SMEs to the possibilities and challenges associated with accessing export markets, and facilitating access to training, information and finance in order to grow their export potential.

The LNDC and BEDCO also have a role in promoting cross-border business linkages, and pursuing sector specific competitive advantages for Lesotho SMEs (including for example the greater integration of Lesotho in a Southern African tourism market).

The importance of streamlining customs regulations and processes and removing disincentives to cross-border trade (including long queues at borders and delays to accessing VAT refunds), as referred to earlier in this section, are also critical.

## 8.12 Tourism

The GoL has identified tourism as a key growth sector. Tourism currently contributes just 1.5 percent to Lesotho's GDP, compared with a regional average of 7 percent. In line with *Vision 2020's* objectives, and with the assistance of the World Bank and Millennium Challenge Corporation, the GoL is developing strategies aimed at promoting tourism as an employer and revenue source.

Lesotho's geography, climate, culture and history offer excellent opportunities for the development of niche tourism products. These include eco-tourism, botanical tourism, adventure tourism,<sup>63</sup> and tourism products focusing on the country's rich heritage in palaeontology (dinosaur footprints) and archaeology (San paintings).. Tourism operators in KwaZulu Natal have had great success in offering historical tours, and there are opportunities for enterprises in Lesotho to link into such tours while capitalising on their own cultural heritage.<sup>64</sup>

Despite the prioritisation of the sector, however, the *Growth Strategy Paper* notes that very few of the 1994 tourism development plans have been implemented, and that there is an absence of integrated tourism planning across the responsible agencies. Tourism development is constrained by inadequate infrastructure, transport and tourism facilities, and confusion in the respective roles of tourism support institutions. Marketing of Lesotho's tourism resources is very under-developed, and there are very few links between tourism operators in Lesotho and South Africa.

The *Growth Strategy Paper* notes that investment in the tourism sector, and particularly foreign investment, is currently not forthcoming owing to severe restrictions created by the land tenure system and ownership. Foreign investors are largely restricted to Special Development Areas, which allows for sub-leases from MTEC of 60 to 90 year duration. Even in these areas, however, a local ownership requirement of 51 percent applies. The *Growth Strategy Paper* notes this as a major impediment to investment,

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<sup>63</sup> Skiing, off-road biking and quad biking, mountain climbing and horse-riding activities are already offered in various parts of the country

<sup>64</sup> For example, KZN has established a well developed niche market for French tourists built on the connection between the Prince Imperial's death and the Anglo-Zulu battlefields. Lesotho could link up with this market given its historic connections with France through the missionaries (Paris Evangelical and Roman Catholic), through packaging "The French Connection experience in Southern Africa."

given the limited availability of Basotho with capital to support this proportion of large investment proposals.

The negative impact on investment provides a clear example of how government policy in some cases exacerbates the 'missing middle' – preventing the development of growth orientated SMEs which could potentially create jobs and opportunities for spin-off enterprises in the local community.

The Lesotho Review 2008 notes that growth in the tourism sector depends on private sector investment, human resource and physical infrastructure development, especially in the highlands, enhanced local entrepreneurship and marketing networks, and greater integration of local communities.

It will also require product differentiation, the building of regional links, the removal of regulatory impediments and strengthening of the sector associations<sup>65</sup> and networks among small tourism operators, as well as a broadening of local horizons so as to understand and respond to the international market.

The Lesotho Tourism Council appears to be largely inactive, despite having received substantial funding from the Private Sector Competitiveness Project to support restructuring, information gathering and development of stronger relations with the LNTD. The negative impact of personal politics on efforts to get the organisation back on its feet was noted by a number of stakeholders.

#### **8.12.1 Implications for GoL**

The apparent ineffectiveness of the Lesotho Tourism Council is a major stumbling block to efforts to grow the sector and develop effective marketing strategies and regional linkages. It appears that the problem lies in confused responsibilities and personal tensions, rather than lack of funding. It may be necessary to review the Council's mandate and structure in order to improve its capacity for effective delivery.

It is strongly recommended that local ownership requirements and land tenure regulations are reviewed in light of the value of joint ventures with large foreign operators as a mechanism for encouraging tourism as a growth sector.

#### **8.13 Accurate data on SMEs**

The *Growth Strategy Paper* notes as an 'overriding constraint' the lack of reliable statistics and market information on business activity in Lesotho, which creates difficulty for both the public and private sectors. The *Growth Strategy Paper* suggests that any improvement in available statistical information would be very useful in supporting economic development.

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<sup>65</sup> Including clarification of roles and responsibilities and improved coordination.

As reported in section 6.5, the lack of comprehensive data on existing business activity in Lesotho was noted as a challenge from the outset of the *State of Small Enterprise* project. Census data is limited to the number of households and people per EA. The Bureau of Statistics undertakes a Labour Force survey on a regular basis, but this does not provide information about the number and type of small enterprises in the economy. The MTICM is currently working toward developing a new database of registered businesses based on trade license applications to the One Stop Shop housed in the Ministry.

While these data sources, which are currently being developed, will be useful in helping to contextualise the survey results, they will nonetheless stop short of providing a reliable estimate of the overall number of small enterprises in Lesotho. A significant number of businesses do not go through the One Stop Shop (or the MTICM) to obtain their licenses. Sole Proprietors (which do not have to register with the Companies Registrar) may receive their licenses through various bodies, depending on the sector in which they operate. An insurance broker, for example, requires an insurance broker's license, which is obtained from the Central Bank. A law firm obtains its license by applying to the Law Society, and a Practice Certificate is issued by the Registrar of the High Court.

In the absence of a single databank which collates this information, it will remain difficult to draw a composite and accurate picture of SME businesses in Lesotho.

#### **8.13.1 Implications for GoL**

The GoL needs to take effective steps to address the information gap, for example by ensuring that the Census or the Labour Force survey captures information pertaining to SME activities.

## 9. Policy recommendations

The major recommendations contained in the *White Paper* remain broadly relevant, and the recommendations presented here are consonant with its general thrust. The GoL's task now is to ensure that these recommendations are implemented in a manner that is coherent, sustained and effective, with appropriate modifications where changed circumstances may require this.

The recommendations below are deliberately situated in the context of the *Growth Strategy Paper*. It is hoped that they in turn will inform the evolution of the *Draft Growth Strategy*, given the critical importance of ensuring that SME policy is integrated into overall growth strategies, and not regarded as a separate issue.

### 9.1.1 Institutional capacity and buy-in

The *Growth Strategy Paper* recognises that Lesotho's ability to implement major reforms is limited by weak financial and administrative capacity. It emphasises the need for reform programmes to target the most binding constraints in order to maximise impact and effectiveness, and recommends strategies and priority actions to this end.

The *Growth Strategy Paper* acknowledges that despite the wide range of studies and donor-funded interventions that have been implemented in Lesotho in recent years, there appears to be limited tangible impact to date. The *Paper* suggests that a number of factors have contributed to this limited positive impact, including the fact that donor-funded policy recommendations and interventions have often been developed externally, without sufficient buy-in from the GoL and/or other affected parties, and without adequate reflection of local knowledge and understanding; such recommendations/interventions have tended not to adequately assess the potential costs and benefits of proposals; and have also not adequately taken into account the GoL's limited administrative capacity to implement suggested reforms.

The *Growth Strategy Paper* emphasises the fact that, if policy recommendations are to make an impact, they need to be focused and prioritised in order to ensure that resources are targeted effectively and efficiently. It also links its recommendations to the budget process and provides a basis on which the growth-oriented activities of the Budget Framework Papers will be developed – in order to ensure that appropriate resources are made available to support the identified priority reforms.

Crucially, it emphasises the importance of encouraging buy-in and ownership from both public and private sector stakeholders who will be responsible for implementing change.

In this spirit, this section presents a specific set of high level policy recommendations. These will be thoroughly discussed and debated with the members of the project

reference group as part of the process of defining actions for change and assigning responsibilities for implementation.

### 9.1.2 Assessment of priority actions to support SME development

As noted in Section 8, it is important to recognise that SME growth can take various forms along a continuum of business activity – and that efforts to encourage and support SMEs need to take effect along this continuum as part of an evolutionary process. The role of the GoL must be that of a facilitator – responsible for creating an environment that encourages private sector development across a spectrum of activities, and facilitating access to appropriate tools and support mechanisms to enable SMEs to develop their capacity and grow over time.

Recommended priorities in this regard can be separated into short-term, fairly immediate objectives, and objectives that address longer-term development.

In the short term, it is recommended that the GoL address a number of priority issues contained in the *White Paper*. Specifically the GoL should endeavour to:

| Priority                                                                             | Key Activities                                                                                                                                                                                                                                                                                                                                                                                                                                                               | Responsible parties                                                                                                |
|--------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|
|                                                                                      | <b>Proposals for further discussion with the Project Reference Group</b>                                                                                                                                                                                                                                                                                                                                                                                                     |                                                                                                                    |
| Resolve the <b>institutional</b> allocation of responsibilities for SME support      | Clarify roles and responsibilities of various institutions with mandate for SME development.<br>Improve communication and coordination across agencies.<br>Public awareness-raising re respective roles and how to access support.                                                                                                                                                                                                                                           | Led by MTICM, and including Ministry of Finance and Development Planning, LNDC, BEDCO                              |
| Explore creative mechanisms to facilitate improved access to <b>markets</b> for SMEs | Encourage and support business linkages programmes (in Lesotho and regionally).<br>Deals securing new foreign investment to include examination of possibilities for local linkages.<br>Facilitate effective information flows between large and small businesses, e.g. forums bringing together large and small businesses to discuss procurement issues/contact database to improve big businesses' awareness of available services/products and capacity among local SMEs | Collaborative effort by LNDC and BEDCO                                                                             |
| Expand government <b>procurement</b> to SMEs                                         | Review current policy and practice to identify possible impediments to SMEs.<br>Advertising for smaller tenders to be actively targeted toward SMEs.<br>Where possible, timeframes to be reviewed to enable improved access by SMEs.                                                                                                                                                                                                                                         | Led by MTICM.<br>Requires buy-in and commitment from all government departments and monitoring at departmental and |

|                                                                                                               |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |                                                                                                                                                                                   |
|---------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|                                                                                                               | Government departments and agencies to commit to paying SMEs within specified timeframe for contracted work.                                                                                                                                                                                                                                                                                                                                                                   | central level.                                                                                                                                                                    |
| Encourage and facilitate the establishment of <b>forums/associations/clusters</b> for business collaboration  | Support to business associations to take into account mechanisms for effective representation of SMEs.<br>Encourage/facilitate development of sector-specific clusters/local associations to achieve shared objectives                                                                                                                                                                                                                                                         | BEDCO in association with sector bodies/representatives                                                                                                                           |
| Develop a culture that recognises and <b>values entrepreneurship</b>                                          | Develop vocational training programmes directed toward developing entrepreneurial skills.<br>Develop programmes to expose young people particularly to dynamic business practices in other countries.<br>Engage with private sector companies (Lesotho and South Africa) to encourage establishment of internships.<br>Raise awareness through media campaigns, e.g. incentives/rewards programmes.<br>Facilitate forums for knowledge sharing among SMEs e.g. at BEDCO sites. | MTICM with support from Ministries of Finance and Economic Development and Education, Lesotho Skills Agency, BEDCO                                                                |
| Continue positive efforts to improve provision of <b>infrastructure</b>                                       | Ensure coordinated planning of physical and communications infrastructure projects across GoL departments and agencies.<br>MTICM to interact with various GOL departments responsible for infrastructure provision to ensure that SME needs are recognised and addressed.                                                                                                                                                                                                      | MTICM in collaboration with other departments and agencies.                                                                                                                       |
| Continue positive efforts to promote improved access to <b>finance</b> for SMEs                               | Explore opportunities for alternative forms of collateral, e.g. capital equipment/secure contracts.<br>Communicate effectively with SMEs re options available to them and where to access support.<br>Engage with commercial banks re measures to support creditors and ensure effective book-keeping                                                                                                                                                                          | MTICM and Department of Finance and Economic Development, in collaboration with commercial banks, Post Bank, and donor programmes aimed at promoting access to credit facilities. |
| Minimise administrative inefficiencies associated with customs procedures and issuing of licenses and permits | Restructure licensing process to focus on information gathering rather than fee generation.<br>Review regulatory framework with a view to encouraging joint ventures between foreign firms and SMEs (with SME as minority owner/share-holder).<br>Streamline customs procedures and permit requirements for imports.<br>Licensing authorities to move toward                                                                                                                   | MTICM in collaboration with LRA (in conjunction with SARS), Company Registrar, One Stop Shop and various sector-specific business licensing authorities.                          |

|  |                                                                                                                   |  |
|--|-------------------------------------------------------------------------------------------------------------------|--|
|  | electronic systems and develop systems to enable sharing and collation of information across departments/agencies |  |
|--|-------------------------------------------------------------------------------------------------------------------|--|

In the longer term, the GoL will need to:

| <b>Priority</b>                                                                                                                                                                                                       | <b>Key Activities</b>                                                                                                                                                                                                                                                                                                                                       | <b>Responsible parties</b>                                                                                                  |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------|
| Focus on developing <b>skills</b> and expanding the <b>horizons</b> of business people and potential entrepreneurs (with a particular focus on young people and business start-ups, as well as more established SMEs) | Full implementation of the TVET policy<br>Support mechanisms to encourage skills transfer, including business linkages, internships for promising entrepreneurs, business exposure programmes abroad, and awareness-raising through media campaigns.                                                                                                        | MTICM with support from Ministries of Finance and Economic Development and Education, Lesotho Skills Agency, BEDCO          |
| Encourage greater integration of Lesotho based businesses in the <b>regional</b> economy and promote cross-border business linkages                                                                                   | Streamline customs procedures, import permits and visa regulations.<br>Improve SMEs awareness of and access to information about export opportunities and associated requirements.<br>Facilitate improved access to information about and training in marketing for SMEs.<br>Encourage greater integration of Lesotho in a Southern African tourism market. | MTICM in collaboration with BEDCO and LNDC and Ministry of Finance and Development Planning.<br><br>Lesotho Tourism Council |

## 10. Annex 1: Overview of Relevant Studies and Initiatives

This report on the *State of Small Enterprise* must be situated in the context of existing strategies and initiatives designed to support the sector.

Lesotho has been the subject of a wide range of studies and initiatives aimed at informing improvements to the business climate. These include:

- The **MTICM White Paper** on the development and promotion of small business (2002), which identifies a number of key constraints, including: access to finance, gender inequality, skills shortages, the high cost of doing business, tax and customs administration, land ownership, licensing, public procurement practices and the lack of integration of local small businesses in supply chains. The White Paper identifies key areas and mechanisms for regulatory reform and strengthening of institutional mechanisms to support small business, and proposes a model for implementation of the proposed reforms.
- The **Integrated Framework Diagnostic Trade Integration Study** (2003), which recommended lowering the cost of trading with South Africa and other SACU partners, establishing a competitive business environment, and pursuing regional regulatory cooperation. Key issues covered by the paper included visa requirements, environmental protections, land leases, infrastructure and provision of information on doing business in Lesotho
- Formulation of a **PSD Strategy** (2004), which aims to retain and attract foreign investors, diversify the market and improve integration with the domestic private sector. It proposes a Minimum Infrastructure Platform, which includes physical infrastructure, human capital development, regulatory reform and financial services, and promotes regional economic integration.
- **Value Chain analysis of selected strategic sectors in Lesotho** (Global Development Solutions, 2004), which focuses on garments, horticulture, sandstone and wool and mohair, and addresses supply side constraints in the areas of physical infrastructure, support services/logistics and investment climate issues. It highlights key constraints in respect of labour productivity, skills shortages and lack of knowledge transfer; poor physical infrastructure; high reliance on imported inputs; lack of market and technical information; and the impact of HIV/AIDS. Other more specific constraints include government policies which discourage local sourcing initiatives (e.g. difficulties regarding VAT refunds), lack of product and market diversification, high concentration of expatriates in management, high transport costs associated with imports from South Africa, limitations created by land tenure regulations; narrow definition of collateral for purposes of accessing credit from commercial banks, and heavy competition from subsidised exports, particularly from South Africa.

- **World Bank Assessment of the Investment Climate**, which highlighted crime, cost of and access to finance, tax administration and rates and macroeconomic stability as key concerns for business
- The **Growth Options Study** (World Bank Country Economic Memorandum) which made recommendations in respect of retaining and attracting foreign investment in the garments industry, improving property rights and land reform, investment in infrastructure, simplification of visa regulations, education and training, improving governance and addressing HIV/AIDS.
- **IMF Article IV**, which identified the need for regulatory reforms, introduction of a property registry and streamlining of land transfers, establishment of a credit information agency, skills development, infrastructural investment and marketing programmes.
- The **Capacity Building Plan for the private sector in Lesotho** (2006)<sup>66</sup> which identifies the biggest constraint facing the private sector as poor understanding of how to identify and capture market opportunities, including opportunities to sell to large foreign companies, regional markets and government, and opportunities for import substitution. The plan highlights lack of: information and understanding of markets; competitive products and services; specifications and standards to guide quality, quantity and delivery of product offerings; contacts and links to other market players; and opportunities to transact with suppliers and buyers. It also notes a lack of intermediary organisations with capacity to source or refer the market to the relevant services and a lack of organisational/institutional support to lobby government. It aims to target sectors with demonstrated growth potential, facilitate market driven demand for BDS and facilitate private sector provision of appropriate BDS, using local firms in conjunction with international providers
- The **Millennium Challenge Compact** (2007), which focuses on improving access to water, health infrastructure and removing barriers to investment. The latter includes improving access to credit, development of a Commercial Court, introduction of national ID cards, introduction of a new payments and settlements system, reforms to land tenure and administration and promotion of gender equality.
- The **Private Sector Competitiveness and Economic Diversification Project** (2007) which aims to improve the investment climate and reduce the costs of doing business, and promote economic diversification through market linkages, skills development and institutional support. Anticipated regulatory reforms include company registration and licensing reform. The project will also provide technical support to LNDC, guarantees to enable small businesses to access loans from commercial banks, a new Leasing Act, targeted marketing of the tourism sector, skills development, support for business associations and HIV/AIDS support.
- The **Interim Poverty Reduction and Growth Strategy Paper** 2008/09, developed by the Ministry of Finance and Development Planning, aims to provide a comprehensive planning framework, which incorporates all areas of GoL expenditure and makes use of sector wide approaches. The full PRGS

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<sup>66</sup> Ministry of Finance and Development Planning, ECI Africa Consulting, March 2006

will be developed by the end of 2009. The IPRGS identifies key constraints to SME development as strong dependence on imported inputs, lack of entrepreneurial and technical skills, difficulty accessing finance and attracting equity investors, institutional and legal barriers such as gender, licensing, land and tax issues, high administrative and real estate costs of doing business and lack of linkages with big industries in Lesotho and South Africa.

The Table below summarises the key focus areas for policy reform and/or institutional support, as recommended by the different studies and initiatives.

|                        | Access to finance | Skills development | Tax/ customs | Regulatory issues | Land tenure | Infra-structure | Market linkages |
|------------------------|-------------------|--------------------|--------------|-------------------|-------------|-----------------|-----------------|
| White Paper            |                   |                    |              |                   |             |                 |                 |
| Integrated Framework   |                   |                    |              |                   |             |                 |                 |
| PSD Strategy           |                   |                    |              |                   |             |                 |                 |
| Value Chain            |                   |                    |              |                   |             |                 |                 |
| World Bank ICA         |                   |                    |              |                   |             |                 |                 |
| World Bank CEM         |                   |                    |              |                   |             |                 |                 |
| IMF Article 4          |                   |                    |              |                   |             |                 |                 |
| MCC                    |                   |                    |              |                   |             |                 |                 |
| Capacity Building Plan |                   |                    |              |                   |             |                 |                 |
| PSCEDP                 |                   |                    |              |                   |             |                 |                 |
| IPRGS                  |                   |                    |              |                   |             |                 |                 |

## **11. Annex 2A: The Quantitative Survey - Methodology and Sampling Framework**

### **11.1 The focus of the survey**

The survey included small enterprises across a range of sectors, and across a variety of geographical sites, selected to represent the diversity of operating environments in Lesotho.

In developing the project proposal, SBP determined that within the available project budget, a sample of 600 enterprises across Lesotho would be the most cost effective means of obtaining a statistically robust picture of the small business sector in the country. Given Lesotho's relatively small size, the sample of 600 provides a broadly representative picture.

Given the objective of the study - namely to improve government enterprise support planning and thereby support the growth and sustainability of small businesses - subsistence farming activities were excluded from the study. Agricultural activities were however represented, with the inclusion in the survey of a small sub-sample of commercial farms with less than 50 employees.

The survey included a number of 'medium' businesses at the larger end of the White Paper's definition of small business. These firms were included on the basis that the survey needed to capture enterprises that are currently in a state of growth, or with potential to grow, and that these medium firms could potentially support further absorption of labour and business growth if appropriate support is available.

Given the White Paper's definition of a small business as "a firm that is independently owned and owner-managed," branch offices of a larger company were not included in the survey.

Cooperatives were also excluded from the survey. MTICM already has good information in respect of this sub-sector, with a comprehensive database of cooperatives numbering 1 700, and has a good understanding of the sub-sector's support needs.

Information about the surveyed enterprise was gained on the primary site of the enterprise's activity. If the businesses being surveyed had more than one location, respondents were asked to provide the addresses of other premises, which were cross checked to ensure against double counting. The respondent in each case was the 'entire enterprise.' If a business owner made her product in one location and sold it in another, for example, the two activities were recognised as belonging to the same business, and the respondent was asked to provide information for the business as a whole.

## **11.2 Project Reference Group and stakeholder engagement**

A project reference group was convened at the start of the project, comprising representatives of MTICM, PSP, the Ministry of Finance, LNDC, BEDCO, the Bureau of Statistics and Lesotho PostBank, among others, together with various representatives of organised business and individual business people. The reference group was chaired by 'Me Motsamai, Director of Industry at MTICM, and provided input and feedback at key stages of the project.

The full reference group met three times during the course of the project. The first meeting was held in mid-February 2008. At this meeting, the project objectives and proposed methodology and survey instrument for the quantitative study were presented for discussion and refinement. The reference group met for a second time in early June, when the headline results of the quantitative study were presented, and the objectives and focus of the subsequent qualitative/case study research was discussed in detail. The final meeting of the full reference group will take place in early September. At this meeting, the draft project report will be discussed. Additional inputs and comments received from reference group members at this meeting will be incorporated into the final project report.

In addition to the meetings of the full reference group, the project also benefited immensely from ongoing engagement over the duration of the study with key members of the reference group, including chairperson 'Me Motsamai and other members of MTICM and the Ministry of Finance, as well as BOS, BEDCO, and representatives of business.

Input received from MTICM, particularly 'Me Motsamai as well as the PSP and the Bureau of Statistics during this phase was central to the process of refining the survey methodology, developing the quantitative survey questionnaire, constructing the sampling framework and selecting survey sites.

## **11.3 The sampling framework**

### **11.3.1 The Livelihood Zones as a basis for sampling**

Consultation with MTICM, PSP and the Bureau of Statistics indicated that the most effective means to ensure a broad representation of geographical locations across Lesotho, while maintaining the integrity of sample sizes, was to use the Lesotho Livelihood Zones, as used by the Lesotho Vulnerability Assessment Committee, as the basis for stratification of the sample. The sample size of 600 provides a broadly representative picture when applied across the Livelihood Zones.

The Livelihood Zones, which are primarily agriculturally based, are widely used by the Lesotho government in classifying communities according to key characteristics. Their use enabled the sampling framework to take into account different local

conditions such as markets, available services and access to infrastructure in different parts of the country.

The Zones divide the country into six geographical regions, differentiated according to factors such as population density, agricultural productivity, primary economic activities and sources of cash in the area, average levels of income, access to markets and infrastructure, and so on. The broad characteristics defining each zone provide a useful basis on which to differentiate the sample, allowing recognition of the broadly urban nature of the Southern Lowlands compared to the largely rural and isolated nature of communities in much of the Mountains Zone, for example.<sup>67</sup>

The sampling framework, determining the distribution of the sample across the Zones, was based on an assessment of existing literature and databases detailing small business activity in Lesotho. The SBP team undertook analysis of a number of existing databases, including:

- The MTICM licensing database (approximately 7000 businesses, mostly Maseru based)
- The new one stop shop database (currently in development, 700 entries at time of review, mostly Maseru based)
- District level licensing data collected by MTICM (approximately 5000 enterprises)
- The Bureau of Statistics Business Register (approximately 4000 entries, across Lesotho reflecting concentration in Maseru).

SBP also met with a representative of the Registrar of Companies in the Ministry of Law and Constitutional Affairs. SBP had hoped to access data regarding registration of businesses per district or town, but owing to the manner in which information is captured by the Office, and the paper-based nature of the system, it was not possible to access information from this source.

The review of databases helped to inform the weighting of zones against the overall sample size, and to identify specific areas where small business activity appeared to be concentrated. On this basis, and informed by the need to ensure an appropriate sampling spread across and within the livelihood zones, the SBP team developed an initial list of proposed sampling sites. The distribution of the sample across each Zone was based on an analysis of both the population living in the zone and the anticipated concentration of enterprise activity in the Zone according to the results of the database analysis.

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<sup>67</sup> The sixth zone is referred to as “urban” and was not considered relevant to this study. The five agricultural zones cover the entire country, and were considered sufficient.

**Table 1: Lesotho's Livelihood Zones - Summary of Key Characteristics**

| <b>Foothill</b>                                                                      | <b>Mountain</b>                                          | <b>Northern Lowland</b>                                                      | <b>Southern Lowland</b>                                                         | <b>Senqu River Valley</b>                                              |
|--------------------------------------------------------------------------------------|----------------------------------------------------------|------------------------------------------------------------------------------|---------------------------------------------------------------------------------|------------------------------------------------------------------------|
| <b>Population per Zone</b>                                                           |                                                          |                                                                              |                                                                                 |                                                                        |
| 235 106                                                                              | 385 991                                                  | 430 658                                                                      | 597 175                                                                         | 122 680                                                                |
| <b>Proportionate distribution of population across zones</b>                         |                                                          |                                                                              |                                                                                 |                                                                        |
| 13%                                                                                  | 22%                                                      | 24%                                                                          | 34%                                                                             | 7%                                                                     |
| <b>Wealth (% households in zone)</b>                                                 |                                                          |                                                                              |                                                                                 |                                                                        |
| Very poor 13%                                                                        | Very poor 15%                                            | Very poor 18%                                                                | Very poor 20%                                                                   | Very poor 15%                                                          |
| Poor 28%                                                                             | Poor 45%                                                 | Poor 25%                                                                     | Poor 33%                                                                        | Poor 35%                                                               |
| Middle 44%                                                                           | Middle 25%,                                              | Middle 40%,                                                                  | Middle 27%,                                                                     | Middle 40%,                                                            |
| Better-Off 15%                                                                       | Better-Off 20%                                           | Better-Off 17%                                                               | Better-Off 20%                                                                  | Better-Off 10%                                                         |
| <b>Coverage</b>                                                                      |                                                          |                                                                              |                                                                                 |                                                                        |
| Botha Bothe to Mochales Hoek                                                         | All districts except Mafeteng & Berea                    | Botha Bothe, Leribe, Berea                                                   | Maseru, Mafeteng, Mochales Hoek                                                 | Mochales Hoek, Quthing, Qachas Nek, Thaba Tseka                        |
| <b>Agricultural productivity and opportunities for income generation</b>             |                                                          |                                                                              |                                                                                 |                                                                        |
| High productivity                                                                    | Sparsely settled. Limited income opportunities           | High productivity                                                            | Low productivity. Limited income opportunities                                  | Unproductive. Limited income opportunities                             |
| <b>Main Markets</b>                                                                  |                                                          |                                                                              |                                                                                 |                                                                        |
| Village shops, supermarkets around main towns                                        | Isolated from services & markets                         | Malls, supermarkets, trading between villages                                | Village shops, supermarkets around main towns                                   | Village shops, supermarkets around main towns                          |
| <b>Business activity</b>                                                             |                                                          |                                                                              |                                                                                 |                                                                        |
| Petty trade, sale of livestock, livestock products, self-employment (firewood sales) | Livestock & crop sales, formal employment, casual labour | Urban areas, textile factories, sale of crops, livestock, livestock products | Formal employment, livestock, crop sales, petty trade, self-employment, brewing | Formal employment, livestock sale, petty trade/village kiosks, brewing |

### 11.3.2 Selection of survey sites

Within each Livelihood Zone, a number of areas were selected within which to sample of SMEs. The selection of survey sites was informed by the need to ensure an appropriate sampling spread across and within the Livelihood Zones. Areas were selected on the basis of their likely ability to present the full range of small enterprises likely to be found in each Zone.

The review of MTICM and Bureau of Statistics databases provided information about the types of business activity in different areas, and a good sense of the geographic spread and concentration of SME enterprises across the country. On this basis, the project team developed an initial list of proposed sampling sites, selecting a mix of site characteristics:

- Larger urban centres
- Good access to markets and suppliers in areas of concentrated enterprise activity
- Located on main roads with good access to passing trade
- Easy access by tarred road
- Smaller, more rural villages
- Isolated areas with limited enterprise activity, very small local markets
- Located in mainly residential areas with little passing trade
- Distant from main roads with only gravel road access

The proposed list was presented to a meeting of representatives of the Ministry of Agriculture and Food Security, who have extensive knowledge of enterprise activity at district and village level. The survey sample was finalised on the basis of the expert input received at this meeting.

The sample framework ensured that the survey reflected a broad cross-section of the small business sector in Lesotho, across business activity and levels of formality/informality. The survey data is thus able to provide a good spread and depth of data on business activity and challenges. Table 2 presents the sample framework and includes brief notes on the sites chosen.

In addition to the main sample, the survey included a small sample of commercial farms (with less than 50 employees). The focus of this sample was on farming interests that produce relatively small amounts of fresh produce for hotels and restaurants in the main urban centres (subsistence farming was *excluded* from the sample). The PSP provided a list of commercial farms from which to sample. The sample was split between crop and livestock farming. Interviews were conducted by telephone. The intention was to achieve a sample size of 20 commercial farms. However, only a limited number of interviews could be secured from the available lists, and it was agreed with the PSP team that the realised sample of 15 was sufficient.

**Table 2: The sample framework (realised sample)**

| Areas sampled per Zone    | Business per area | Total per zone | Notes                                                                                                                                                                                            |
|---------------------------|-------------------|----------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Southern Lowland</b>   |                   |                |                                                                                                                                                                                                  |
| Maseru City               | 125               | <b>214</b>     | Large majority of businesses concentrated in Southern Lowland Zone, particularly Maseru City                                                                                                     |
| Kingsway Road             | 51                |                | CBD – concentration of retail and services                                                                                                                                                       |
| Moshoeshoe Road           | 18                |                | Broad mix of business sectors represented, formal and informal enterprises                                                                                                                       |
| Sea Point                 | 10                |                | Mainly informal enterprises in more residential area, off main road                                                                                                                              |
| Lithabaneng               | 26                |                | Mix of formal and informal, main road and residential, MTICM database shows concentration of registered enterprises                                                                              |
| Qoaling (Loretta)         | 23                |                | Mix of formal and informal, main road and residential, BOS database shows concentration of registered enterprises                                                                                |
| Maseru Bedco Estate       | 15                |                | Selected from 53 listed BEDCO enterprises                                                                                                                                                        |
| Morija                    | 30                |                | Small urban centre, craft and tourism                                                                                                                                                            |
| Mafeteng                  | 35                |                | District capital, small urban centre. Industry, retail and service enterprises.                                                                                                                  |
| Mafeteng Bedco Estate     | 6                 |                | 41 listed BEDCO enterprises                                                                                                                                                                      |
| <b>Northern Lowland</b>   |                   |                |                                                                                                                                                                                                  |
| Maputsoe town             | 46                | <b>136</b>     | Centre for textile and garment factories. High concentration of retail and services (formal/informal) near border post. Mix of formal and informal general dealers/services in residential areas |
| Botha Bothe               | 46                |                | District Capital, medium urban centre. Mix of formal and informal, high concentration of businesses on main road, some manufacturing and hardware off main road.                                 |
| Botha Bothe Bedco Estate  | 5                 |                | 37 listed Bedco enterprises                                                                                                                                                                      |
| Teyateyaneng              | 29                |                | District capital, small urban centre, crafts industry and retail                                                                                                                                 |
| Khabo                     | 10                |                | Very small, rural, limited access to markets and transport                                                                                                                                       |
| <b>Senqu River Valley</b> |                   |                |                                                                                                                                                                                                  |
| Quthing (Lower Moyeni)    | 30                | <b>68</b>      | District capital, small urban centre, footwear and textiles                                                                                                                                      |
| Mount Moorosi             | 21                |                | Smaller urban settlement, gravel road, less access to markets and transport                                                                                                                      |
| Sekake                    | 17                |                | Very small rural settlement, gravel road, distant from markets                                                                                                                                   |

| <b>Foothills</b>        |    |            |                                                                                              |
|-------------------------|----|------------|----------------------------------------------------------------------------------------------|
| Matelile                | 22 | <b>47</b>  | Small town, some tourism, general dealers, good road access, distant from main urban centres |
| Mapoteng                | 15 |            | Gravel road, some distance from main urban centres, isolated from markets                    |
| Ramabanta               | 10 |            | Isolated rural settlement, some tourism                                                      |
| <b>Mountains</b>        |    |            |                                                                                              |
| Mokhotlong              | 37 | <b>130</b> | Small urban centre, mainly retail, some tourism, far from main urban centre of Maseru        |
| Qacha's Nek             | 37 |            | Small urban centre. Varied economic activity, some tourism                                   |
| Semonkong               | 33 |            | Isolated rural area, gravel road, some tourism                                               |
| Mphaki                  | 14 |            | Small settlement on main road, some distance from main urban centres                         |
| Mapholaneng             | 9  |            | Small settlement on main road, far from main urban centre of Maseru                          |
| <b>Commercial farms</b> |    | <b>15</b>  |                                                                                              |
| <b>Grand Total</b>      |    | <b>610</b> |                                                                                              |

The realised sample differed slightly from the proposed sample, as a result of adjustments made once in field. Specifically: The proposed sample of 25 businesses along Kingsway road in Maseru was doubled, owing to the heterogeneous mix of businesses offered by the site, including businesses in the professional and services sector, which were less well represented in other sample sites. Sample sizes in the remaining sites in Maseru town centre were slightly decreased. Further, in two of the remote rural areas selected for sampling, the number of businesses available for interview was lower than the proposed sample size. In a third rural site, the strong concentration of small and informal retail enterprises presented a very homogenous sample, and the sample size was thus decreased to allow a corresponding increase in a more diverse site. Sample sizes in the Northern Lowlands and Mountains zones were increased to compensate for the lower numbers achieved in the Foothills zone.

Table 3 provides a breakdown of the proportion of the sample per district, in each of the eight districts in which sample sites were selected.

**Table 3: Realised sample per district (excluding commercial farms)<sup>68</sup>**

| <b>District</b> | <b>Number</b> | <b>% of sample</b> |
|-----------------|---------------|--------------------|
| Maseru          | 216           | 35                 |
| Mafeteng        | 63            | 10                 |
| Quthing         | 65            | 11                 |
| Leribe          | 56            | 9                  |
| Qacha's neck    | 54            | 9                  |
| Botha-Bothe     | 51            | 8                  |
| Mokhotlong      | 46            | 8                  |
| Berea           | 44            | 7                  |
| <b>Total</b>    | <b>595</b>    | <b>100</b>         |

The sampling interval in each site was finalised by the project team and the Field Manager, and varied according to the apparent concentration of businesses in the area, and according to the general geographical spread of the settlement. This approach ensured that a varied cross-section of businesses in both the formal and informal sectors was captured.

In very small centres, such as Khabo, enterprises were randomly selected across the whole community. In somewhat larger areas such as Maputsoe and Botha Bothe, the sample was split between a main road, and secondary roads and residential areas off the main road, with a concentration on the former.

In Maseru, where a far larger concentration and range of businesses exists, specific areas within the city were purposively selected to ensure that a broad variety of businesses were included. Within these areas, each business was enumerated in order to capture the broad spread of businesses in each site.

The relevant respondent was the business owner. In about a third of cases, the business owner was not available, and a senior manager with appropriate knowledge of the business was interviewed instead.<sup>69</sup>

### **11.3.3 Questionnaire design**

The survey questionnaire was developed in consultation with the project reference group, with further input from discussions with individual stakeholders, including PSP, MTICM, the Ministry of Finance and BEDCO. The instrument comprised mainly closed questions, with a limited number of open-ended questions about challenges facing businesses and areas in which support is required.

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<sup>68</sup> As noted above, the primary sampling frame was the Livelihood Zones, rather than districts. As a result, not every district in the country was represented.

<sup>69</sup> 65% of respondents were owners of the business for which data was gathered, 35% were senior managers

#### **11.3.4 Training and Survey Pilot**

The Lesotho Bureau of Statistics (BOS) provided valuable assistance to the project team in the sourcing of enumerators. Fourteen BOS enumerators were selected to participate in three days of intensive training on the research objectives, questionnaire and sampling methodology, together with basic research ethics and interviewing skills.

A one-day pilot was conducted in Maseru, in which all fourteen enumerators participated. The pilot tested enumerators' understanding of the questionnaire and their ability to administer it properly, as well as the relevance and appropriateness of the questionnaire for businesses of different types. Minor changes were made in respect of the phrasing of certain questions based on the pilot feedback, but no substantial changes were necessary.

Enumerators were debriefed following the pilot, with particular attention to developing enumerators' probing skills, which were vital to obtaining depth of detail for the open-ended questions. Based on the Field Manager's assessment of the enumerators' skills, professional attitude and the pilot results, nine enumerators were selected to conduct the survey.

#### **11.3.5 The Fieldwork Process**

On arrival at each community, the survey team introduced themselves to the relevant authority (the District Administrator, local Ministry of Trade, Local Chief or local counsellor), and provided them with a savingram from the reference group chairperson, 'Me Motsamai, explaining the purpose of the survey and requesting their assistance.

Once identified, business respondents were provided with a similar savingram from 'Me Motsamai, requesting their participation in the study. In most cases, interviews were secured on the first or second call to the business. However the interview itself often took longer than anticipated, owing to respondents needing to temporarily halt the interview to attend to business.

In general, there was no marked difference between formal and informal business respondents' attitudes to being asked to participate in the survey. Enumerators did experience some difficulty securing interviews with businesses in the service sector in Maseru, as respondents were concerned about the time required.

A number of interviews were completed with Chinese-owned businesses. In a small number of cases the Chinese business owner was unable to conduct the interview in English or Sesotho. In some cases, a staff member acted as an interpreter, and in a small number of cases the interview had to be terminated and a new respondent found.

#### **11.3.6 Qualitative research / case studies**

Following the quantitative survey, a further phase of qualitative research was undertaken, in order to examine in greater depth some of the key issues and challenges highlighted by the quantitative study. Key government stakeholders

interviewed during this phase included representatives of MTICM, the Ministry of Finance and the LNDC. A range of business organisations were consulted, including the LCCI, Mohloli Chamber of Business, Women in Business, and the Lesotho Tourism Council. Individuals representing big business interests were also interviewed, including senior managers from one of Lesotho's large banks, and owners and managers of major textile and garment-producing factories. Follow-up interviews were held with a selection of small businesses that had participated in the quantitative survey, in order to probe particular issues in more depth. In addition, the project team had discussions with IFAD regarding the Rural Finance Intermediation Programme.

Design of the qualitative research instruments was informed by the results of the quantitative study and refined in discussion with the project Reference Group. The qualitative interviews were conducted using semi-formal discussion guides that allowed for open-ended responses. This approach enabled respondents to express their views and share particular concerns and problems. Businesses were encouraged to share their personal experiences and difficulties, as a way of helping to contextualise the quantitative study.

## **12. Annex 2B: The Quantitative Survey – Detailed Findings**

The key objective of the State of Enterprise study was to provide information to inform Government enterprise support programming. This requires information on the distribution and activities of small enterprises and characteristics of small business owners, as well as an exploration of the challenges and opportunities faced by small enterprises. This Annex provides the detailed survey findings as follows:

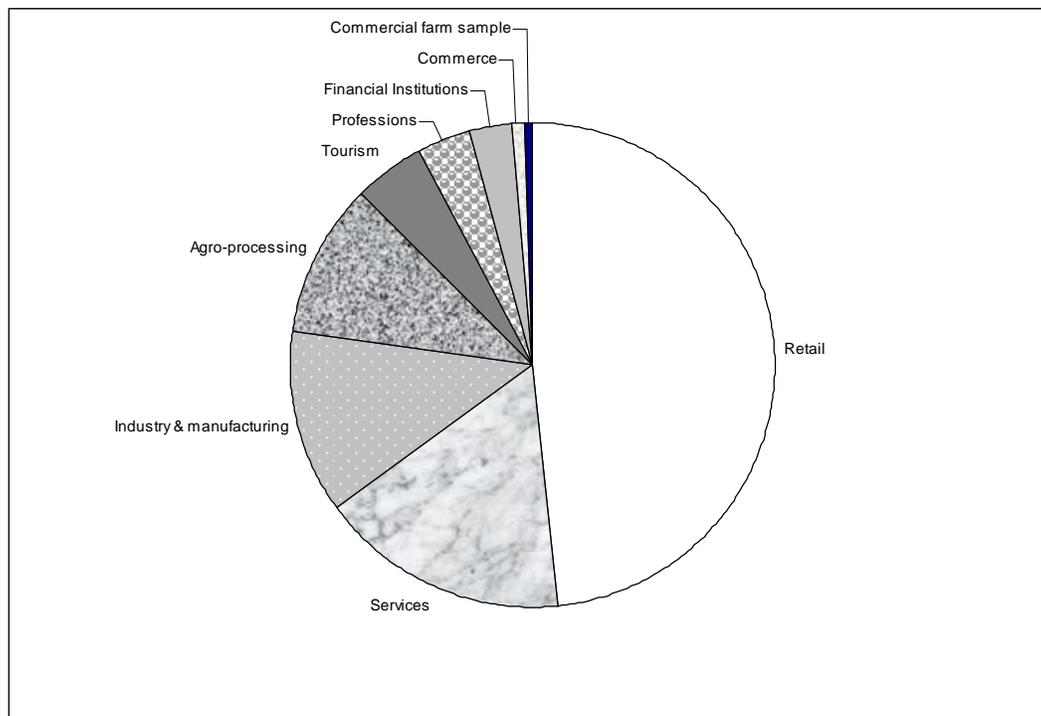
- Distribution across economic sub-sectors
- Business size (employee numbers and turnover)
- Characteristics of small business owners
- Registration and licensing
- Business growth
- Key challenges giving small businesses
- Awareness and use of business support services
- Perceived gaps in government support

### **12.1 Distribution across economic sub-sectors**

As noted in Annex 2A, the sampling process at different sites varied according to the apparent concentration of businesses in the area and geographical spread of the settlement. In very small centres enterprises were randomly selected across the whole community. In larger areas, the sample was split between main roads, secondary roads and residential areas. In Maseru, specific areas within the city were purposively selected and each business was enumerated in order to capture the spread of businesses in each site. This approach ensured that a varied cross-section of businesses was captured at each site, and provides a picture of the concentration of business activities in different sectors.

The majority of small and medium businesses covered by the survey were retailers, followed by businesses offering a range of services. Businesses in the industry/manufacturing sector and agriculture/agro-processing made up fairly small proportions of the sample. Very few businesses were involved in the tourism, professions or financial sectors. Figure 1 shows the breakdown of the sample by sector.

**Figure 1: Breakdown of businesses by sector**<sup>70</sup>



It is not surprising to find the survey sample, with its focus on SMEs, largely skewed toward the tertiary sector, and specifically retail. Secondary sector businesses such as textile manufacturing and construction tend to be dominated by larger businesses, and are often characterised by substantial start-up and operating costs. Retail and services, in contrast, which together account for 70 percent of the sample of small businesses, provide relatively easy market entry for small and micro firms in both the formal and informal sectors, require relatively little start-up capital at the smaller end of the market, and for the most part require no specific formal training. Businesses included in the retail sub-sector include a range of enterprises from mini-supermarkets and general dealers, to shops selling furniture, clothing and stationary, to sellers of airtime and informal sector hawkers. The services sub-sector includes repair services, hire of equipment, transport services and couriers, and personal services such as hair dressers and beauty salons.

Industry and manufacturing, which comprised 13 percent of the small businesses sampled, included construction and supply of construction materials, small manufacturing of various products including pharmaceuticals, small machines and tools, as well arts and handicrafts.

<sup>70</sup> The number of businesses that fall into each sector adds up to 644. Some businesses described activities that spanned two sectors. Where it was possible to ascertain what the primary business activity was the business was coded into this sector. Where this was not possible, two codes were assigned to the business based on the rationale that if a business genuinely carries out activities that span two or more sectors, the business will be affected by relevant conditions pertaining to more than one sector.

Agriculture and agro-processing (11 percent of the sample) included growing, sales and processing of plant/vegetable products, meat and dairy processing and manufacture of general groceries, as well as home-brewing.

Tourism was treated as a separate sub-sample within the survey, given the sector's high growth potential. The *Growth Strategy Paper* estimates that the sector currently comprises between two and four percent of Lesotho's economy. The small enterprise survey identified five percent of the sample as tourism businesses. These included restaurants and bars, accommodation, travel agents and tour operators.

Professions (four percent of the sample) included medical practitioners, pharmacies and business services, while financial institutions (three percent of the sample) included micro-lenders and insurers. The commerce sub-sector included businesses specialising in telecommunications and ICT, but only one percent of businesses sampled were classified in this sector based on their primary activity.

## 12.2 Business size (employee numbers and turnover)

### 12.2.1 Employee Numbers

The Lesotho White Paper categorises as SMEs those businesses with less than 50 employees.<sup>71</sup> Businesses are further broken down into micro, small and medium enterprises:

- Micro businesses: 0 – 2 employees
- Small businesses: 3 – 9 employees
- Medium businesses: 10 – 49 employees

The survey asked respondents to state the number of full time staff members employed by the business (whether formally or informally employed). Seventy percent of the businesses sampled were micro-enterprises, with two employees or less. Just over a third of these were single person operations. Table 2 shows the distribution of responses against the White Paper's micro, small and medium business categories.

**Table 2: Size of business by employee number<sup>72</sup>**

| Category                 | Number of businesses in sample | Percentage of businesses in sample |
|--------------------------|--------------------------------|------------------------------------|
| Micro (0 – 2 employees)  | 430                            | 70.5%                              |
| Small (3 – 9 employees)  | 140                            | 23%                                |
| Medium (10-49 employees) | 40                             | 6.5%                               |

The largest business in the sample reported having 40 employees. The mean number of employees was 2.6.

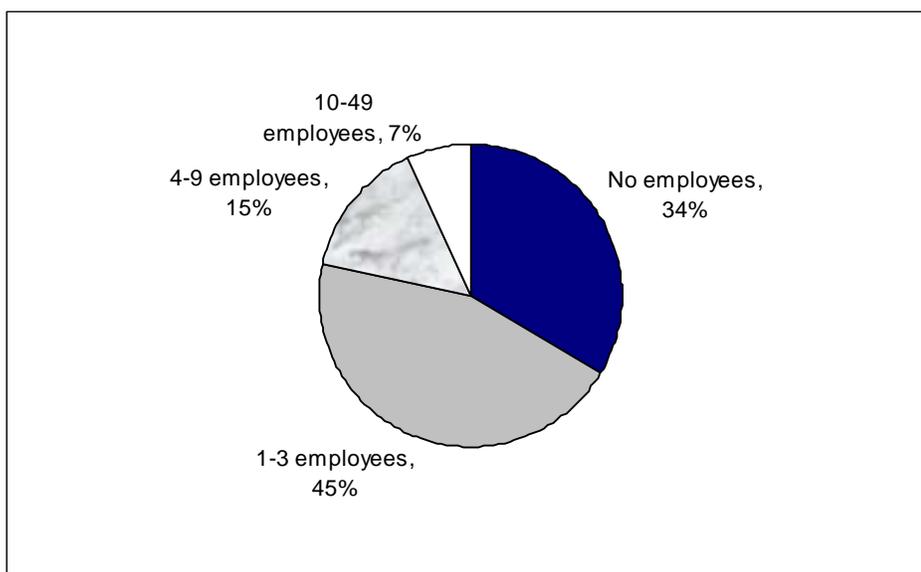
<sup>71</sup> MTICM White Paper on the development and promotion of small business, September 2002

<sup>72</sup> n=610

The White Paper on small business development notes that: “The conventional categorisation of small business into ‘micro’, ‘small’ and ‘medium’ based on employee numbers “is crude and somewhat arbitrary. Moreover, Lesotho’s poor data on small business renders the quantitative distinctions sought here even more uncertain. As a result, the definition employed here... is simply a rough working definition. It might be appropriate to change it in response to either developments in the economy of Lesotho, improved research and information or both these factors.”<sup>73</sup>

Bearing these caveats in mind, it is useful to look at the breakdown of size by employee numbers in a slightly different way, in order to develop a better sense of the composition of the sector, as presented in figure 2. Just over a third of the sample comprised single operations with no employees, 45 percent had between one and three employees, and only 15 percent had between 4 and 9 employees. Thus, if micro-businesses were redefined to include businesses with up to three employees, this size category would account for 79 percent of the sample.

**Figure 2: Breakdown by employee size (alternative categories)<sup>74</sup>**



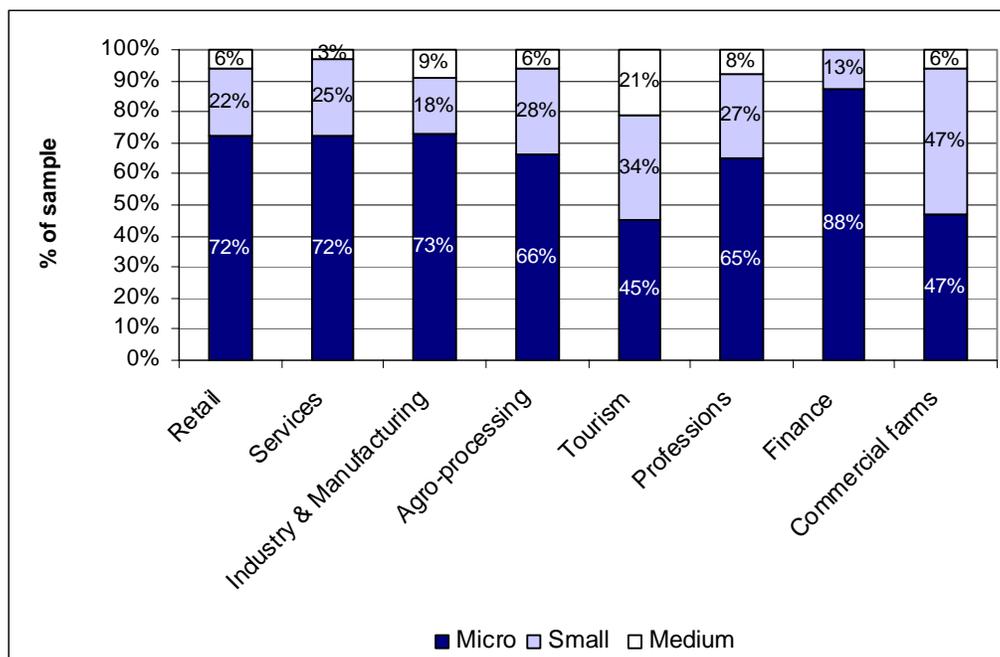
The relative sizes of small businesses in the sample showed considerable variation across sectors. The tourism sector was the only one to show a fairly high concentration of medium businesses (21 percent), while the financial sector sample included no medium size businesses at all. The tourism sector also had the highest proportion of small businesses (34 percent), followed by agriculture/agro-processing (28 percent) and professions (27 percent). Financial institutions, industry/manufacturing, services and retail all showed a strong concentration of micro-enterprises (over 70 percent in each sector). The commercial farms sub-sample showed an even split between micro and small businesses (47 percent each) and a very small proportion of medium sized businesses. (Note: the commerce sector sub-

<sup>73</sup> Lesotho White Paper

<sup>74</sup> n=610

sample is not included in this breakdown, since it included only three enterprises). The results are shown in figure 3.

**Figure 3: Sample by size of businesses (number of employees) per sector<sup>75</sup>**



One of the objectives of the survey is to provide a better understanding of the range of SMEs that operate in different types of locations. For the purposes of investigating the impact of location on businesses, businesses were classified into three groups, depending on the particular survey site, as shown in Table 3:

**Table 3: Categorisation of businesses according to location**

| Main urban centres well located                                           | Small centres relatively well located          | Small/medium centres remotely located                                                               |
|---------------------------------------------------------------------------|------------------------------------------------|-----------------------------------------------------------------------------------------------------|
| Well located on main, accessible transport routes                         | Relatively well located                        | Isolated from main urban centres, not easily accessible                                             |
| Good access to suppliers and government services                          | Access to suppliers and markets                | Limited access to suppliers or markets                                                              |
| Maseru including Lithabaneng and Qoaling; Botha Bothe; Maputsoe; Mafeteng | Teyateyaneng; Khabo; Quthing; Morija; Mapoteng | Mokhotlong; Mapholaneng; Qacha's Nek; Semonkong; Ramabanta; Mphaki; Mount Moorosi; Sekake; Matelile |

The average size of enterprises, measured by number of employees, showed considerable variation according to geographical location of the businesses. Businesses in the "main urban centres" and "small relatively well located" areas tended to be larger, as measured by employee numbers, than businesses in more remote areas.

<sup>75</sup> n=610

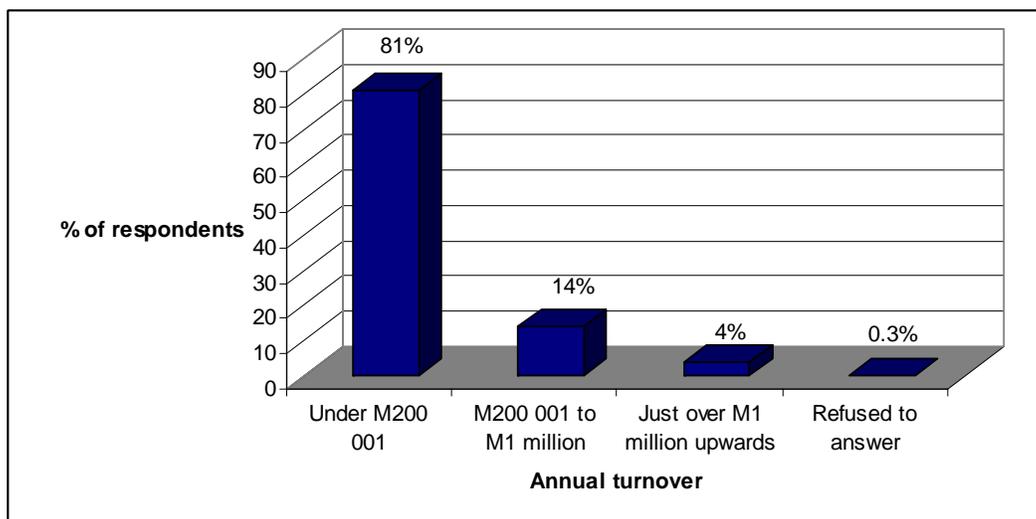
### 12.2.2 Turnover

In order to provide a more comprehensive picture of the composition of the small businesses in Lesotho, the sample was analysed by turnover as well as employee numbers. The large majority of businesses reported annual turnover below M200 000. Less than four percent reported turnover above M1 million – suggesting that the very large majority of small businesses are survivalists, and may have limited potential for growth and expansion.

It should be noted that data on enterprise turnover is notoriously difficult to gather accurately in surveys relying on respondent estimates. The turnover data collected for the current study is no exception, and results should be read with some caution. It is likely that annual turnover is grossly underestimated in many cases. This is particularly likely for very small, informal or unsophisticated businesses in the survey, most of whom do not keep accurate financial records. Respondents may consciously understate their business turnover, owing to concerns about taxation, for example. In addition, despite clear instructions from enumerators to state turnover (the total sales in a year), some businesses may have provided information on net annual income.

In an effort to verify the turnover data reported by respondents to the survey, all responses were checked against sectors and activities undertaken by the business, employee numbers and registration, as well as against monthly rentals where applicable. Where data was clearly incorrect it was removed and coded as missing. The 'cleaned' data is presented using broad turnover bands, as shown in figure 4.

**Figure 4: Composition of sample by annual business turnover<sup>76</sup>**



It is possible that many of the small enterprises surveyed generate a very small turnover, particularly given that the sample included hawkers and other very small and

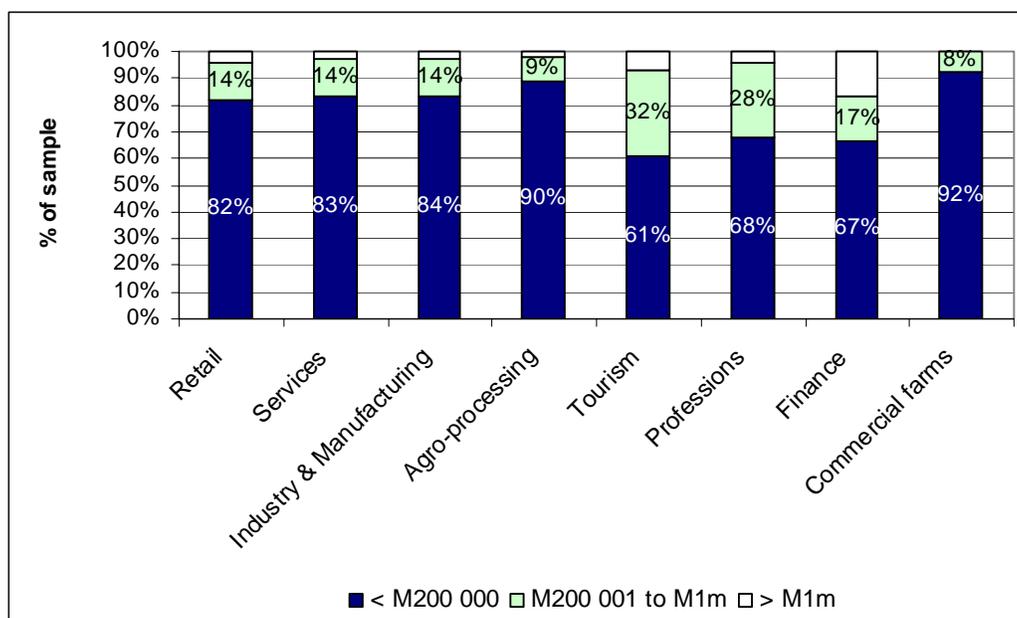
<sup>76</sup> n=575.

informal retailers. Nonetheless, it should be noted that within the smallest turnover band shown in figure 4, almost a quarter of respondents (23 percent) reported annual turnover of under M10 000 per annum, which is extremely low.

Among the very small proportion of enterprises reporting annual turnover above M1 million (3.8 percent of the sample), 3 percent reported turnover between M1 and M5 million, and 0.8 percent over M5 million.

As noted above, the tourism was the only sector with a fairly high concentration of medium businesses and small businesses (55 percent) as measured by employee numbers. The results by turnover similarly show a higher proportion of larger businesses in the tourism sector, with seven percent of businesses reporting annual turnover above M1 million, and just under a third with turnover between M200 000 and M1 million. In contrast, the retail, services and industry/manufacturing sectors show a high concentration of businesses with turnover under M200 000 per annum (above 80 percent), while in the agriculture/agro-processing sector, 90 percent of firms fall into the smallest turnover category. Businesses in the financial and professional sectors show a broader spread of business sizes across the turnover bands. The commercial farming sub-sample, despite showing an even split between micro and small businesses as measured by employee numbers, shows a high concentration of businesses in the smallest turnover band (92 percent).

**Figure 5: Sample by sector and turnover band<sup>77</sup>**



Results suggest significant differences in business turnover according to geographical location. Businesses located in the “main urban centres” and, to a lesser extent, the “small but well located centres,” were considerably more likely to report higher annual turnover.

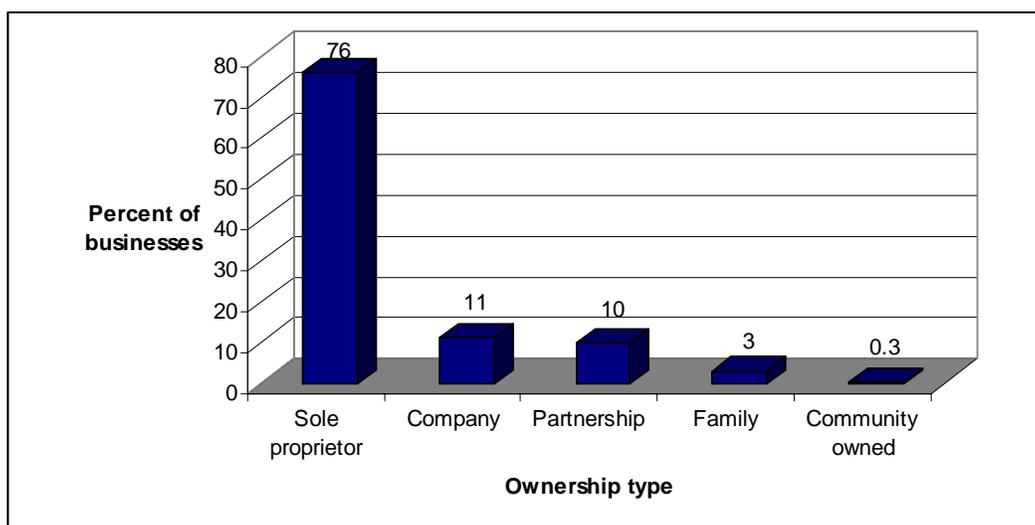
<sup>77</sup> n=568

In many cases, the cross tabulation of variables such as registration for tax, or problems faced by businesses, against business size shows statistically more significant differences between categories when measured by turnover, rather than by employee numbers, as a measure of business size. In the case of this particular survey, annual turnover, although difficult to gather with accuracy, provided a useful delineator of business size and sophistication.

### 12.2.3 Ownership type

The large majority of businesses were sole proprietors. This is indicative of the very limited nature of business operations in many cases, and again confirms a tendency toward micro-scale, mainly survivalist activities among businesses in the sample. The breakdown of business ownership type across the sample is presented in figure 6.<sup>78</sup>

**Figure 6: Breakdown of sample according to ownership type<sup>79</sup>**



## 12.3 Characteristics of small business owners

### 12.3.1 Gender

Businesses covered by the survey showed a fairly even split in terms of the gender of the business owner. Just over half the business owners were male (52 percent) and just under half (48 percent) were female.<sup>80</sup> However, the gender split among the higher turnover businesses was strongly skewed toward male business owners. Among businesses reporting between M200 000 and M1 million turnover per annum, male ownership increased to 63 percent, while for businesses with turnover above M1million,

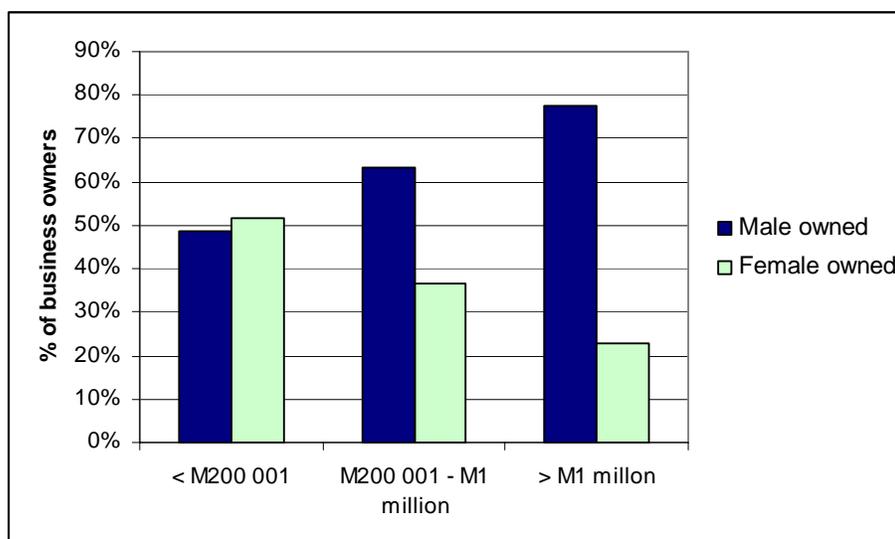
<sup>78</sup> Note: These categories reflect the choice of the respondent, and do not necessarily correspond with the legal status of the business.

<sup>79</sup> n=601. Two respondents referred to their business as "community owned".

<sup>80</sup> n=608

male ownership was very predominant at 77 percent. It appears that women were far more likely to own survivalist enterprises with very small annual turnover.

**Figure 7: Breakdown of annual turnover by gender of business owner<sup>81</sup>**



### 12.3.2 Age

The majority of business owners surveyed (57 percent) were between 31 and 50 years old. The age breakdown of business owners in the sample is shown in Table 4. Twenty eight percent of the sample was aged over 50, while only 15 percent were less than 30 years old. This low number of young entrepreneurs is interesting, given that the survey included both formal and informal sector businesses and a significant number of micro-enterprises.

**Table 4: Age of business owner<sup>82</sup>**

| Age           | Percent of businesses |
|---------------|-----------------------|
| Less than 21  | 0.8                   |
| 21-30         | 14.2                  |
| 31-40         | 30.1                  |
| 41-50         | 26.7                  |
| 51-60         | 20.4                  |
| Older than 60 | 7.8                   |

### 12.3.3 Education Levels

Education levels reported by the business owners in the survey showed very wide variation – with a considerable proportion reporting relatively high levels of education.<sup>83</sup>

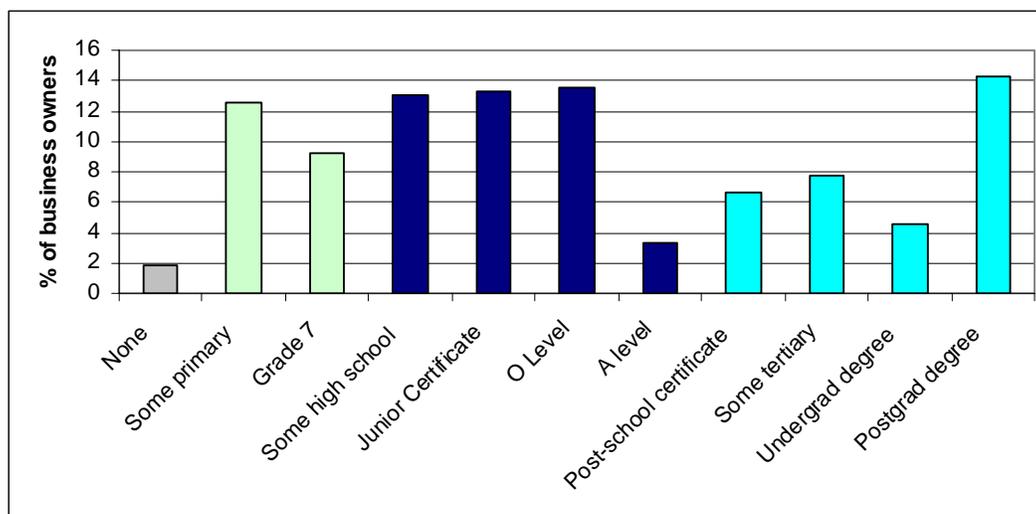
<sup>81</sup> n=572

<sup>82</sup> n=591

<sup>83</sup> n=608. Where it was possible, business owners who were educated outside of Lesotho were coded to fit the equivalent level of Lesotho education.

Nineteen percent of the business owners in the sample had completed tertiary education, and of these 14 percent had post-graduate degrees. Thirteen percent had some further training after school (not necessarily completed). Thirty percent of respondents had obtained a school leaving certificate, at Junior Certificate level (13 percent), O-level (14 percent) or A-level (3 percent). The remaining respondents, comprising about a third of the sample, had some high school education (13 percent), had completed primary school (9 percent) or had some primary school education (13 percent). Only two percent of business owners sampled reported having no education at all.

**Figure 8: Education levels of SME owners**



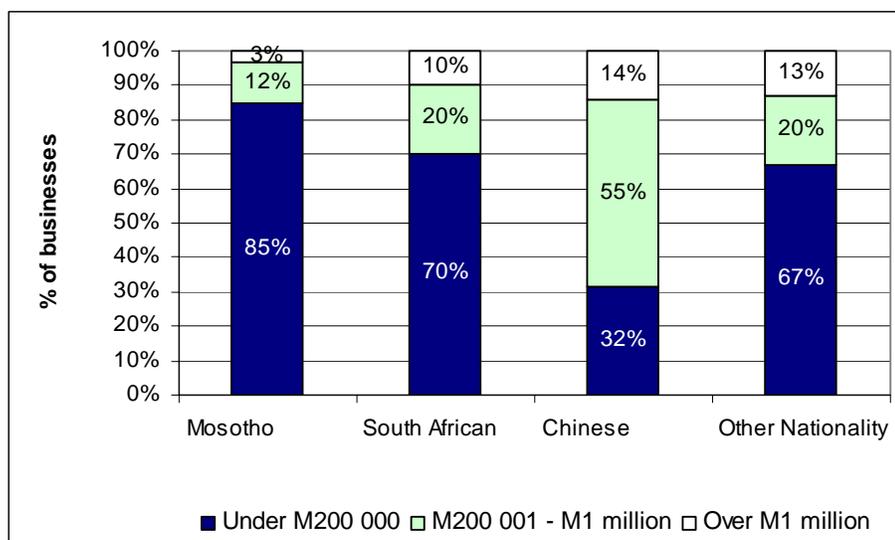
### 12.3.4 Nationality

The large majority of the businesses sampled (92 percent) were owned by Basotho. Four percent of the businesses were owned by Chinese nationals, two percent by South Africans, and two percent by other foreign nationals.<sup>84</sup>

Nationality of business owners showed considerable variation by size of business (as measured by business turnover). Eighty-five percent of Basotho-owned businesses were very small, with turnover of R200 000 or less. In contrast, only a third of the Chinese-owned businesses fell into the smallest turnover category. Just over half the Chinese-owned businesses reported turnover of between R200 001 and M1 million.

<sup>84</sup> n=607

**Figure 9: Nationality of business owner against annual turnover<sup>85</sup>**



### 12.3.5 Other sources of income

The large majority (77 percent) of business owners in the sample owned only one business.<sup>86</sup> Among the 23 percent that did own another business, most (72 percent) owned one other business, 16 percent owned two other businesses, and 9 percent owned three other businesses. The majority of these additional businesses (60 percent) were in another sector, or involved different activities to the business for which data was being collected.

Only one business owner owned another business outside the country (in South Africa). Eighty percent of the 'other businesses' were located in the same district as the business for which data was captured.

For 90 percent of the businesses surveyed, the business was the individual's only source of income generation, i.e. the business owner was not employed by another business. Nine percent of respondents had formal-sector paid employment outside the business being surveyed. A further 1.5 percent was employed by other enterprises in the informal sector.<sup>87</sup>

### 12.3.6 Employment patterns

The sample showed an almost even split between proportions of male and female employees – 51 percent of total employees were female, and 49 percent were male.<sup>88</sup> There was however some differentiation among individual businesses – with 63

<sup>85</sup> n=572

<sup>86</sup> n=610

<sup>87</sup> n=610

<sup>88</sup> n=1598 employees. No data for two businesses. Sum of all employees referred to (question 11) = 1594.

percent of businesses reporting that they employed one or more male employees, and 80 percent saying they employed one or more female employees.<sup>89</sup>

While employees were for the most part full time, paid staff, many do not have the protection of a formal employment contract. The vast majority of businesses employed some or all of their staff on a full time basis (97 percent), while only eight percent of respondents said that they employ part-time staff. Only 4 percent of businesses said that they employed casual staff (working on an ad hoc or irregular basis).

However, more than half of the businesses surveyed reported that they employed all or some of their staff on an informal basis, without an employment contract. Half the respondents said that all or some of their staff do have employment contracts (there is a slight overlap between respondents, since a single business may have different arrangements for different employees).

**Table 5: Breakdown of employee type by business<sup>90</sup>**

| % of sample                             |                                   |                                 |
|-----------------------------------------|-----------------------------------|---------------------------------|
| All/some staff employed full-time       | All/some staff employed part-time | Employ casual staff             |
| 97%                                     | 8%                                | 4%                              |
| All/some staff have employment contract |                                   | All/some staff without contract |
| 50%                                     |                                   | 54%                             |
| All/some staff are paid                 |                                   | All/some staff unpaid           |
| 95%                                     |                                   | 8%                              |
| All/some staff are family members       |                                   | All/some staff are non-family   |
| 33%                                     |                                   | 83%                             |

A third of respondents said that they employ family members in their business (either exclusively or in addition to non-family members), while 83 percent employ at least some staff who are not family members.

Across the sample, 92 percent of all employees were full-time, and 52 percent had employment contracts. Family members accounted for 21 percent of employees. Three percent of employees were unpaid.

<sup>89</sup> n=400. Two respondents did not respond.

<sup>90</sup> n=402 (i.e. all those businesses with employees). Calculated by adding up all responses where one or more staff was noted in each category. Note that this was a multiple response question, respondents could have both full time and part time staff for example. Answers may thus add up to more than 100%

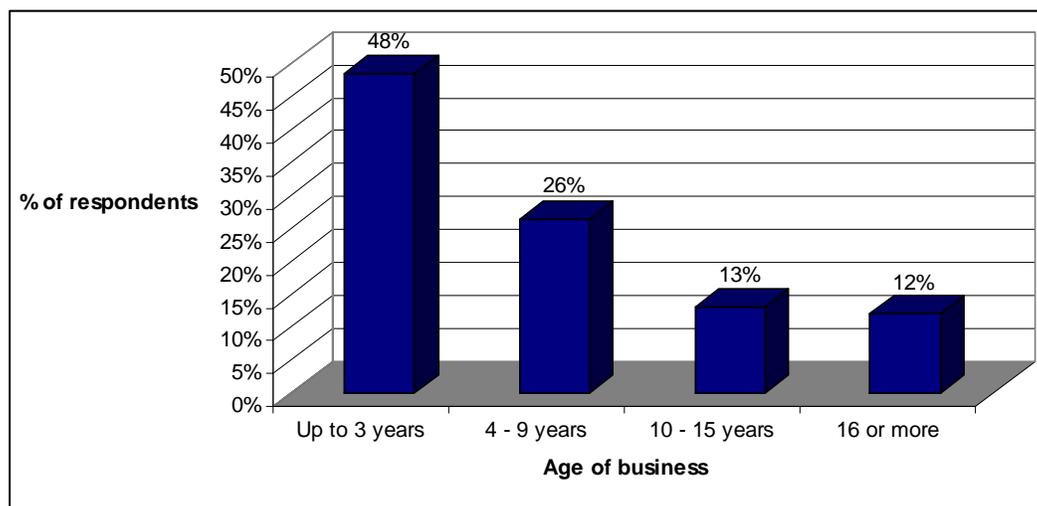
**Table 6: Breakdown of employee type<sup>91</sup>**

|                          |                        |        |
|--------------------------|------------------------|--------|
| Full time                | Part time              | Casual |
| 92%                      | 5%                     | 3%     |
| Have employment contract | No employment contract | –      |
| 52%                      | 48%                    |        |
| Paid                     | Unpaid                 | –      |
| 97%                      | 3%                     |        |
| Family member            | Non-family member      | –      |
| 21%                      | 79%                    |        |

### 12.3.7 Longevity and growth

Most of the businesses surveyed had been in business for less than 4 years, as shown in figure 10. However, a small number of businesses had been in operation for a very long period, which pushed the average age of the businesses across the sample up to 7 years.<sup>92</sup>

**Figure 10: Breakdown of sample according to age of businesses<sup>93</sup>**



### 12.3.8 Nature of business premises

The majority of respondents (61 percent) rented the property from which they ran their business, and just under a third owned the property. Nineteen percent of businesses in the sample were run from the home of the business owner.

Seventy eight percent of businesses in the survey were run from formal premises and 22 percent from informal premises. A comparison of data on business premises against formal registration of the business showed that 20 percent of business in informal premises reported that they were registered for tax.

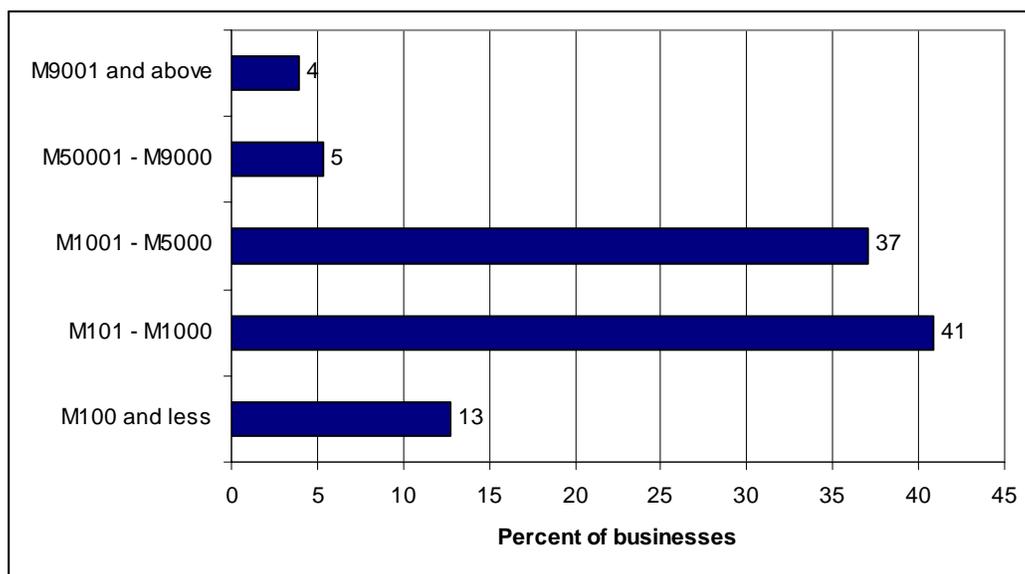
<sup>91</sup> Full/ part time/ casual n=1586, Contract/ no contract n=1580, paid/unpaid n=1561, family/non family n=1451.

<sup>92</sup> n=601. Business which has been in operation the longest: 88 years, followed by 60 years.

<sup>93</sup> n=601

The majority of businesses in the survey reported paying between M100 and M5000 per month in rent for their business premises. The relatively large proportion (41 percent) paying between M100 and M1000 per month is indicative of the large number of informal businesses included in the survey. Thirty-seven percent of the sample reported paying between M1000 and M5000 per month. This includes many of the businesses situated on BEDCO-sites, which report paying between M1500 and M3000 per month on average. Only nine percent of businesses reported paying over M5000 a month rent. Figure 11 shows the breakdown of monthly rent paid by businesses in the sample.

**Figure 11: Breakdown of amount paid in rent per month<sup>94</sup>**



BEDCO tenants in Maseru and Botha Bothe complained about the high rate of annual rental increases. BEDCO was also criticised for charging high rentals without spending money on maintaining the sites.

## 12.4 Registration and licensing

The very high occurrence of informal and survivalist small businesses in the Lesotho economy was apparent during assessment of the survey sites. These observations are supported by a large number of studies which show that a large proportion of Lesotho's small enterprises operate in the informal sector.

The White Paper on small business development defines informal businesses as those that are neither formally registered nor within the government's tax net (i.e. registered with the Lesotho Revenue Authority).

<sup>94</sup> n=359. The median rent paid was M900, and the mean was M1,952. The maximum rent paid was M15 000.

In order to operate in the formal sector, companies are required to register with the Registrar of Companies, and then to obtain a trading or manufacturing license from the MTICM. Partnerships must register with the Deeds Office in the Ministry of Local Government, and obtain an MTICM license as above. Sole Proprietors register directly with the MTICM.

Ten percent of surveyed businesses said they were registered with the Registrar of Companies. This corresponds with the proportion of businesses in the sample identifying themselves as companies (i.e. ten percent, see section 15.2).

The majority of businesses in the sample identified themselves as sole proprietors (76 percent), and would thus be required to register directly with the MTICM.

A small business must be able to demonstrate that it operates from viable premises in order to qualify for a license from MTICM. This site, an office or shop, has to be inspected by government officials before the license can be issued. The Health Department checks that the building has water, electricity and is clean and of a good standard. Small business owners noted that this requirement limits the ability of some businesses to formalise themselves. If they are successfully operating a business but are operating from a structure that would not meet MTICM's approval, they are unable to apply for a license.

The MTICM business license needs to be renewed every year, and applications for renewal must be accompanied by a tax clearance certificate. According to small business owners interviewed, the process of renewing the license is quick and easy, although it does need to be done in person at the relevant office. Some respondents suggested that it would be more efficient if renewals could be done online, saving them having to leave their business to stand in a queue.

Fifty percent of the businesses surveyed reported that they had an MTICM trade license. Of these, the large majority (84 percent) were registered with the Lesotho Revenue Authority.<sup>95</sup> It is not clear whether the business licenses held by all the respondents are up to date, however, since official practice requires production of a tax clearance certificate in order for a business license to be renewed.

A further 20 percent of the sole proprietors in the sample held other licenses. It was however difficult to ascertain from respondents whether all licenses mentioned were official licenses, at national or district level, or whether some were voluntary. This precluded the use of 'other licenses' as a criterion for classifying businesses as 'formal' or 'informal'. Thirty percent of businesses in the sample stated that they had no official license or permit at all – and were thus operating entirely in the informal sector. Table 7 shows the proportion of businesses reporting that they held particular types of licenses:

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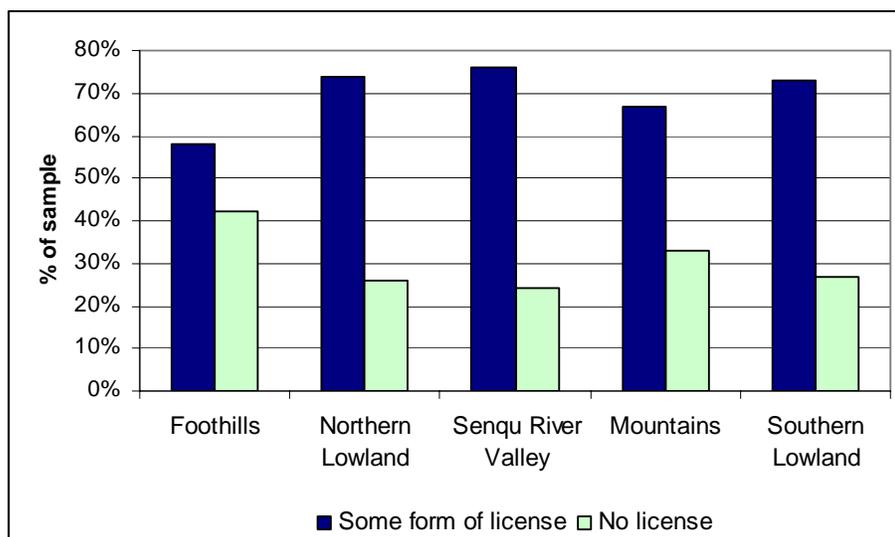
<sup>95</sup> n=294

**Table 7: Businesses by type of license<sup>96</sup>**

| License type                          | Percent of businesses |
|---------------------------------------|-----------------------|
| Trade license                         | 50                    |
| Sector-specific license (unspecified) | 8                     |
| Hawkers permit                        | 4                     |
| Liquor license                        | 2                     |
| License/permit from Chief             | 1                     |
| Manufacturing license                 | 0.2                   |
| Other <sup>97</sup>                   | 5                     |
| No license                            | 30                    |

Businesses located in the Foothills zone were least likely to hold some form of license (58 percent), compared to businesses in the Southern Lowlands, Northern Lowlands and Senqu River Valley Zones, where approximately three quarters of businesses had some form of license. Table 11 shows the geographic distribution of businesses' license status across each Livelihood Zone.

**Figure 12: Licensed businesses per Livelihood Zone<sup>98</sup>**



#### 12.4.1 Registration with the LRA

Just over half the businesses surveyed (52 percent) were registered with the Lesotho Revenue Authority. One company was registered for tax in another country.<sup>99</sup>

<sup>96</sup> n=602

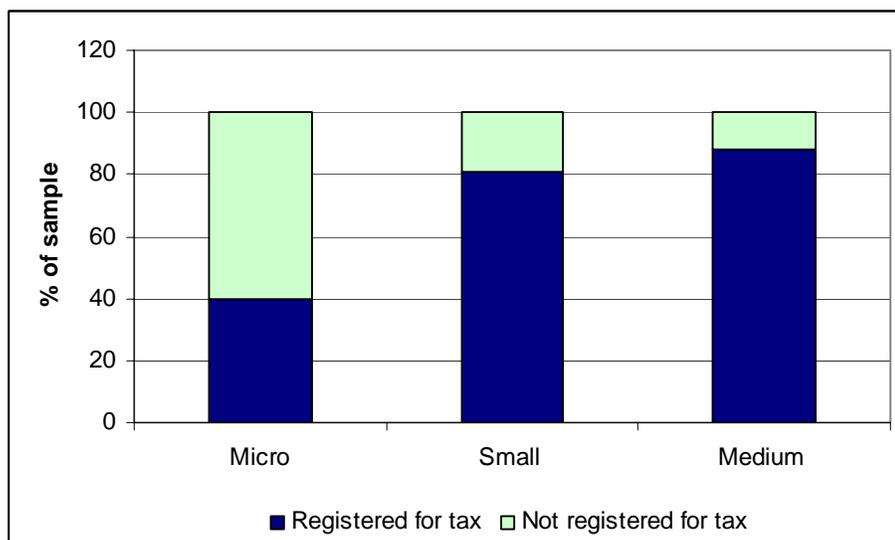
<sup>97</sup> Taxi license and public phone license issued by Lesotho Telecommunication (4 responses respectively), Catering license (3 responses), License from Central Bank, License from Traffic Department and LTA license (2 responses respectively), C-Permit, I-Permit, Small Business license, Motor Garage license, Bakery license, Insurance license, License for drilling boreholes, Permit to sell milk, TVD license and Driving school license (1 response each).

<sup>98</sup> n=602

<sup>99</sup> n=606

The large majority of medium businesses were registered for tax (88 percent), compared to only 40 percent of micro businesses. The smallest firms in the sample were for the most part not registered for tax – 76 percent of businesses with no employees were not registered.

**Figure 13: Size of business (number of employees) by tax registration<sup>100</sup>**

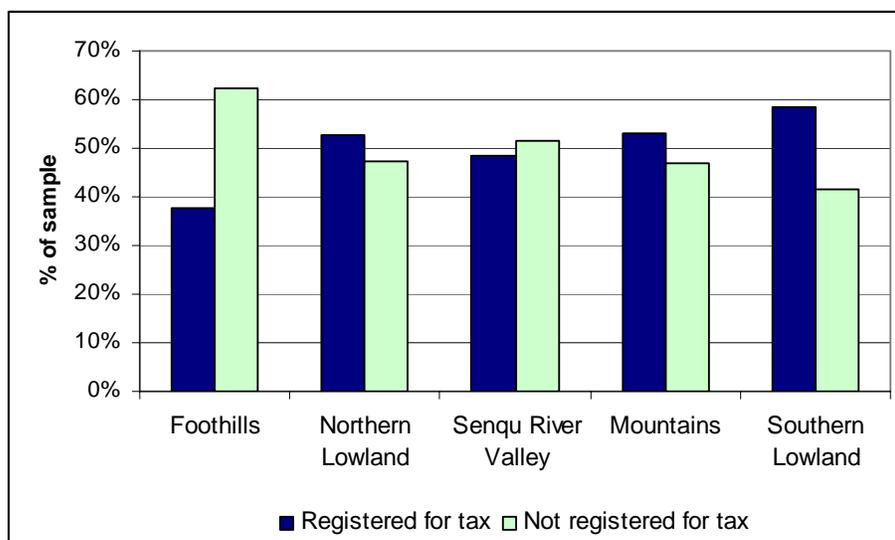


If registration for tax is used as the minimum requirement for categorisation of a business as formal, just under half of the sample may be classified as informal (48 percent). This correlates fairly closely with the proportion of businesses holding trade licenses, manufacturing licenses and sector-specific licenses – which constitute 42 percent of the sample.

Tax registration per Livelihood Zone is presented in figure 14. The Southern Lowland had the highest level of tax registration (58 percent), and the Foothills the lowest (38 percent). This distribution corresponds closely with the proportions of businesses holding some form of license per zone, with the exception of the Senqu river Valley, which has the fourth lowest level of tax registration, despite having the highest proportions of businesses with some form of licensing. In all other zones the proportion of tax registered businesses is about 20 percent lower than the proportion of businesses reporting some form of license.

<sup>100</sup> n=605

**Figure 14: Tax registration per Livelihood Zone<sup>101</sup>**



The majority of businesses that indicated having some form of license (70 percent of the sample) also reported that they are registered for tax (74 percent). In contrast to the general sample, sixty percent of the commercial farmers had no form of license and eighty percent were not registered for tax.

**Table 8: Businesses with or without a license per tax registration status<sup>102</sup>**

| License                    | Registered for tax | No tax registration |
|----------------------------|--------------------|---------------------|
| Enterprises with license   | 73%                | 27%                 |
| Enterprise without license | 4%                 | 96%                 |

## 12.5 Business growth

Respondents were asked whether their business had experienced growth in turnover and in terms of employee numbers in the last three years.

Just less than 40 percent of respondents said that their business turnover had increased in the period (38 percent). It should however be noted that for businesses that do not keep financial records or keep very basic records, an increase in turnover may reflect an increase in inflation rather than an increase in real annual sales. A third of businesses said their turnover had remained the same over the past three years, and 20 percent said that turnover had declined.<sup>103</sup>

Businesses were much less likely to report an increase in employee numbers. Fourteen percent of respondents said that they had increased their staff complement in

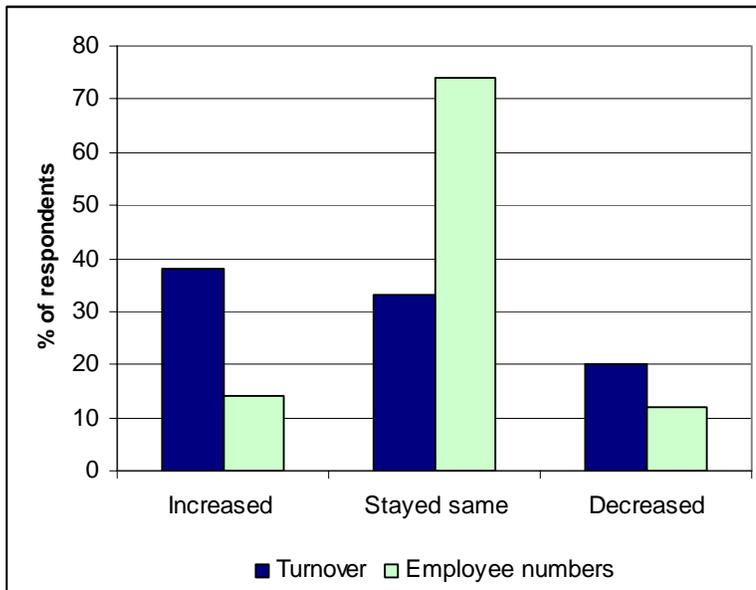
<sup>101</sup> n=606

<sup>102</sup> Only one business was registered for tax in another country. All other businesses were either not registered for tax, or registered with the LRA.

<sup>103</sup> n=581

the past three years, 74 percent of businesses reported unchanged employee numbers and 12 percent of businesses said that their employee numbers had decreased.<sup>104</sup>

**Figure 15: Business growth over the past three years, by turnover and staff size**



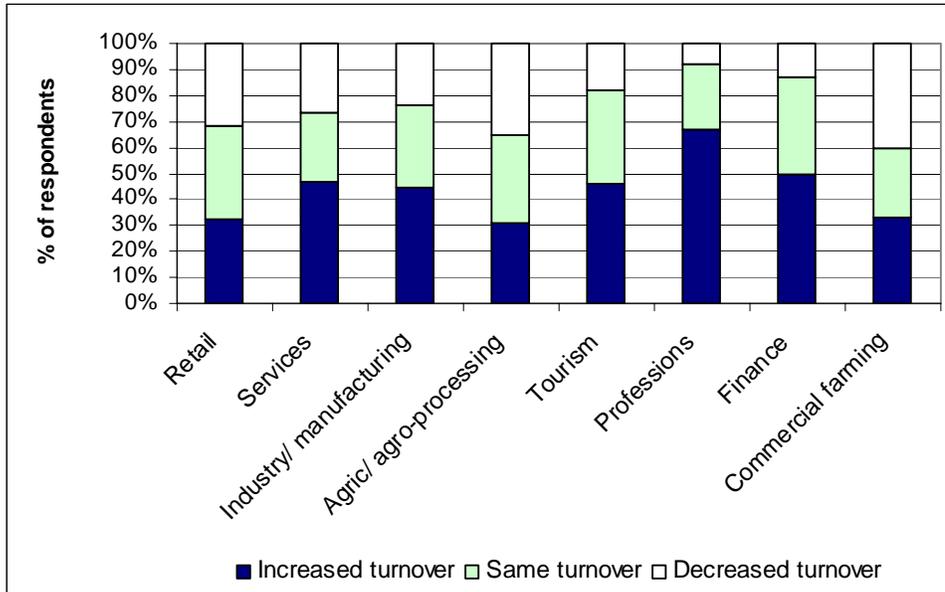
Businesses in the professions sector were most likely to have experienced growth in turnover (68 percent). Businesses in the financial, tourism, services and industry/manufacturing sectors also showed a tendency toward growth, with over 40 percent of respondents in each sector reporting increased turnover in the past three years. In contrast, over a third of both commercial farmers and businesses in the agriculture/agro-processing sector reported a decrease in turnover, as did just under a third of retail businesses.<sup>105</sup>

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<sup>104</sup> n=586

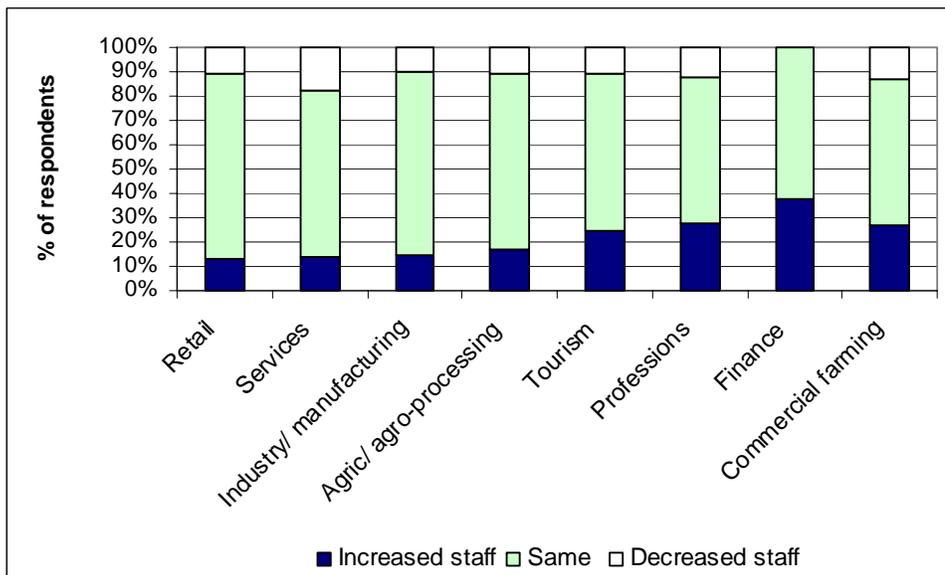
<sup>105</sup> n=581

**Figure 16: Change in annual business turnover per sector**



Similarly, employee numbers over the past three years were most likely to have increased in the finance, professions and tourism sectors. Interestingly, about a quarter of commercial farmers reported increases in staff numbers – despite the high proportion of businesses in this sector reporting decreased turnover. For the large majority of businesses across sectors, however, employee numbers had remained largely unchanged.<sup>106</sup>

**Figure 17: Change in employee numbers per sector**



Interestingly, the survey results did not show a strong correlation between business growth as measured by turnover and whether the business was formal or informal

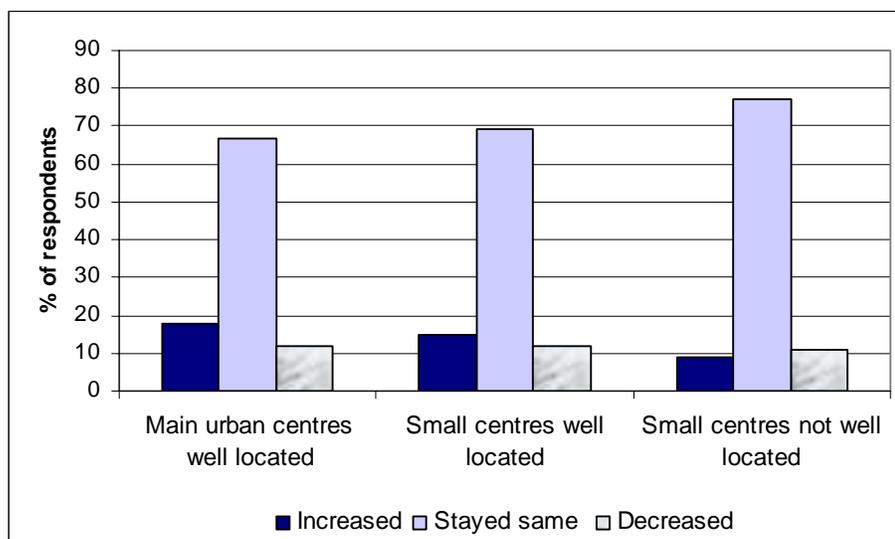
<sup>106</sup> n=586

(registered for tax or not registered). Forty percent of registered businesses reported increased turnover over the past three years, compared to 37 percent of non-registered businesses. Registered businesses were more likely to report a decrease in turnover (33 percent) than non-registered businesses (23 percent).<sup>107</sup> In contrast, registered businesses were considerably more likely to report fluctuations in employee numbers (both increases and decreases) – this may be largely as a result of the concentration of single person and micro-enterprises in the informal sector.

No significant relationship was found between changes in turnover or employee numbers and gender of the business owner. There was also no significant correlation between changes in turnover or employee numbers and the length of time the business had been in operation.

Geographical location of businesses appears to bear a positive correlation with business growth as measured by increased number of employees. A larger proportion of businesses located in “main urban centres” and “small but well located” areas businesses reported increased staff numbers, compared to those in “not well located” areas.

**Figure 18: Change in employee numbers per business location category**

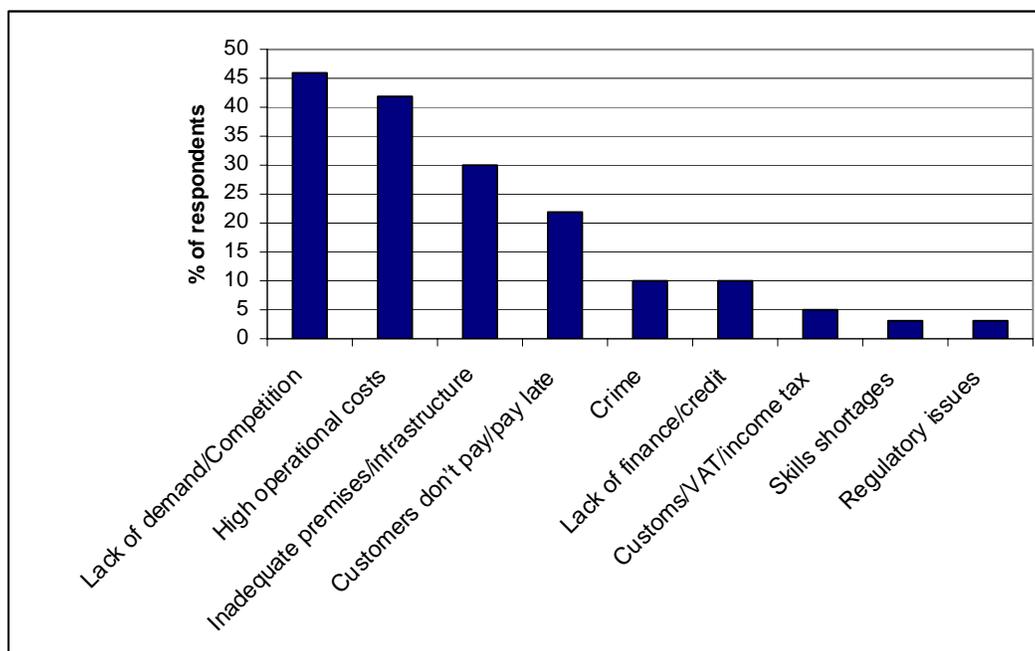


## 12.6 Key challenges facing small businesses

The survey asked business owners to identify the primary challenges facing their businesses. The nature of responses underlines the extent to which many small businesses are unsophisticated, survivalist concerns – focusing on immediate local issues such as lack of demand and high levels of competition, high operational costs, limited access to basic infrastructure and problems associated with the informal structures from which they operate. Figure 19 illustrates the main responses.

<sup>107</sup> n=576

**Figure 19: Main challenges facing businesses<sup>108</sup>**



### **12.6.1 Lack of demand, competition and saturated markets**

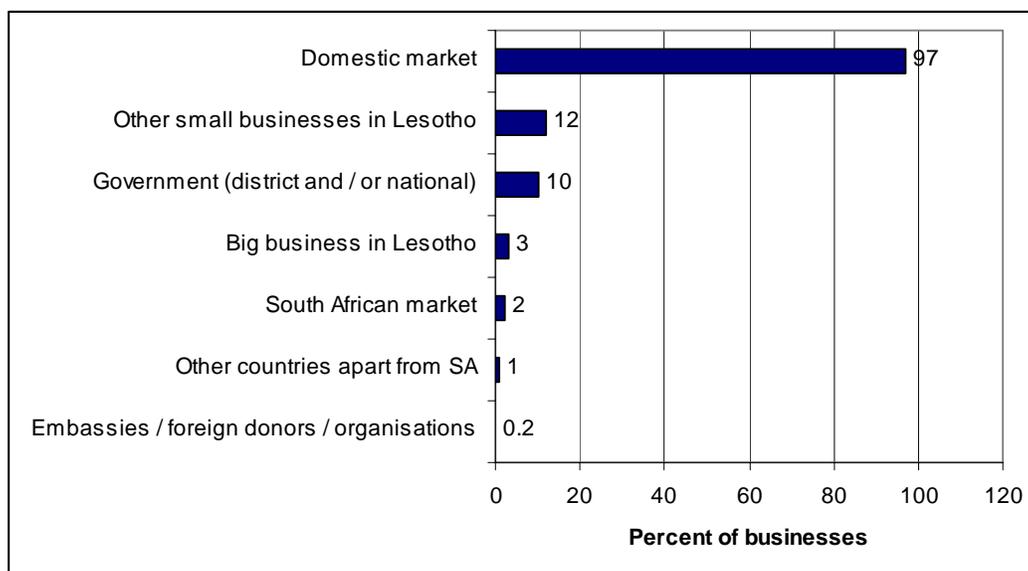
Lack of demand and/or lack of customers was the most frequently stated problem facing small businesses (31 percent of respondents). The tendency for small businesses to focus on 'lack of demand' is however a fairly common response in any survey of this sort, and is also likely to reflect the uncompetitive nature of businesses. Indeed, competition from other businesses was also a common response (15 percent of respondents) - suggesting lack of differentiation of products and services.

A third of the mentions of competition referred specifically to competition from Chinese or Indian businesses, and resentment of Chinese-owned businesses was a common theme throughout the survey.

The extent to which small businesses in Lesotho provide goods and services to the South African market appears to be very limited. Ninety seven percent of sampled businesses reported that their goods and services are for the domestic market. Only three percent of respondents said that they provide goods or services to markets of consumers in South African and/or other countries. The picture was slightly different among commercial farms – eighty percent served mainly the domestic market, while 20 percent also served the South African market.

<sup>108</sup> n=596

**Figure 20: Breakdown of markets supplied by surveyed businesses<sup>109</sup>**



Access to adequate local markets for goods and services showed considerable variation across the different zones. The large majority of surveyed businesses in the Northern and Southern Lowlands and Senqu River Valley reported that they were satisfied with their access to local markets for sale of their goods and services. In contrast, as many as 20 percent of respondents in the Mountains zone and 30 percent of respondents in the Foothills zone said that their access to local markets was inadequate – underlining the relative isolation of many businesses in these predominantly rural areas.<sup>110</sup>

A respondent also provided a vivid example of the lack of market differentiation:  
“There were people who used to sit on a corner with popcorn machines. This would be successful in one corner of Maseru. And then in a month those machines were everywhere. The market is easily saturated, and they are competing against each other now, bringing their prices right down. The problem is lack of ideas. In this small market we need diversity in ideas.”

### **12.6.2 High operational and input costs**

Twenty-three percent of respondents said that high operational costs were a major challenge facing their businesses. Concerns about operational costs included high rental costs and labour costs, as well as limited access to tools, equipment and transport owing to the high costs of these inputs.

High input costs are closely related to limited access to local suppliers and difficulties accessing supplies at wholesale prices. Eleven percent of businesses talked about

<sup>109</sup> n=610. Note that this was a multiple response question and percentages can therefore add up to more than 100.

<sup>110</sup> n=589

poor or limited relationships with suppliers. Qualitative interviews with small business owners revealed that many businesses source their supplies from companies in South Africa – from Bloemfontein all the way to Johannesburg, Durban and even Cape Town. The limited availability of wholesalers within Lesotho means that small businesses have to travel further afield to access supplies, but are then required to factor the transport costs into their selling price, which limits their competitiveness. Respondents also noted that since they generally purchase fairly limited volumes, they are unable to access the discounts which benefit bulk buyers.

### **12.6.3 Cash-flow/ late payments**

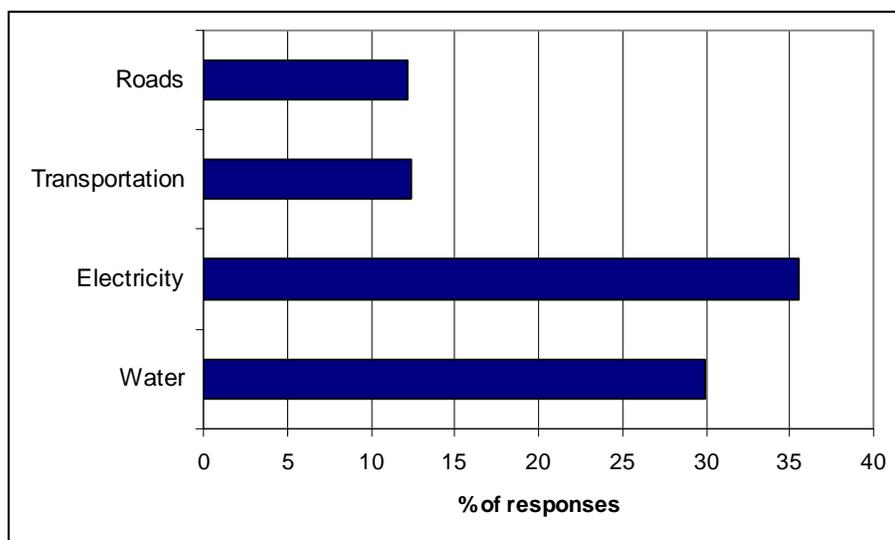
Just under a quarter of respondents (22 percent) mentioned cash-flow problems caused by customers paying late or not at all (buying on credit) as a major challenge for their businesses, while a further six percent mentioned 'difficult customers.' Government was a frequently mentioned late-payer, with businesses stating that their small size did not enable them to carry costs over the long period of time that government takes to pay its suppliers.

### **12.6.4 Infrastructure**

Inadequate infrastructure was raised by 13 percent of respondents as a key challenge for their businesses. This included limited access to water, electricity, sanitation and/or telecommunications infrastructure. Just over a third of businesses reported having inadequate or no access to electricity. Thirty percent had inadequate or no access to water. Inadequate access to transport and poor quality roads were identified as problems by about 12 percent of businesses in each case.

Poor access to water and electricity were also frequently mentioned in relation to problems associated with informal business premises. Other problems for businesses in informal premises included inability to secure the premises against criminals, and the impact of adverse weather, as well as the inability to provide a comfortable environment for customers to shop in or to conduct business matters with privacy.

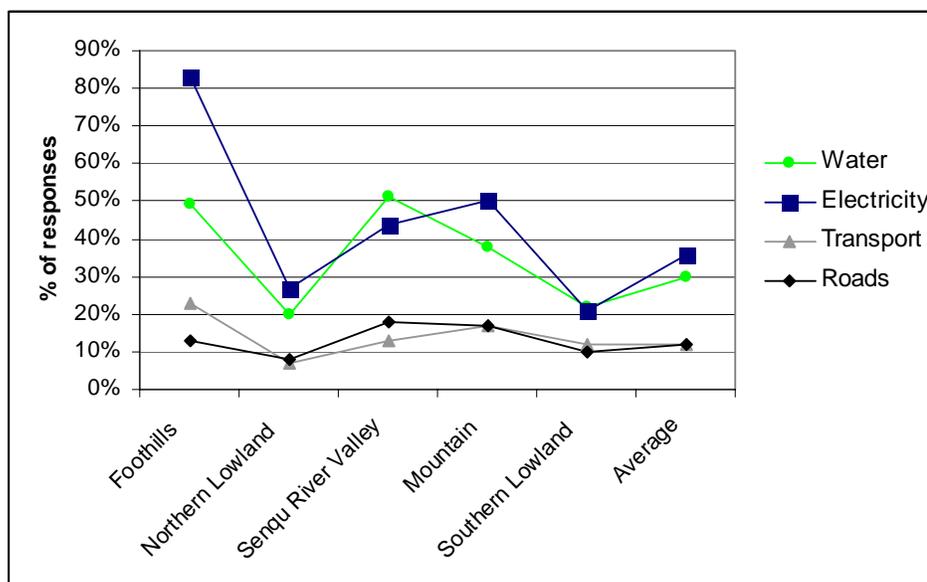
**Figure 21: Proportion of businesses reporting inadequate access to infrastructure**



Access to appropriate infrastructure showed some variation across the Livelihood Zones. On average, businesses in the Southern and Northern Lowland Zones, where survey sites were concentrated in the larger urban areas, reported better access to infrastructure than businesses in the other zones where sites were often more remote.

As noted above, a larger proportion of businesses in the Foothills, Mountains and the Senqu River Valley zones operated from informal premises (28 percent, 33 percent and 21 percent, respectively). Businesses operating from informal premises are less likely to be linked into formal provision of services such as water and electricity. Nonetheless, it appears alarming that as many as 83 percent of businesses in the Foothills zone reported that they had inadequate or no access to electricity, as did half the businesses in the Mountains zone. Businesses in the Foothills and Senqu River Valley zones were also most likely to report inadequate or no access to water (half the businesses surveyed in each zone).

**Figure 22: Businesses with inadequate or no access to infrastructure, by Zone<sup>111</sup>**



Access to infrastructure also showed considerable variation across sectors. The vast majority of businesses in the finance and professional sectors reported adequate access to water (between 90 and 100 percent in each sector). In contrast, a quarter of businesses in the industry/manufacturing and agro-processing sectors - many of which are likely to rely on water in their production processes – described their access to water as inadequate or absent. The services and tourism sectors also showed a significant proportion of businesses without adequate access to water (24 percent and 21 percent respectively). Retail sector businesses were the most likely to describe their access to water as inadequate (37 percent) – but it should be borne in mind that this sector included a large proportion of informal retailers operating from make-shift premises, as well as hawkers.

Access to electricity showed a similar pattern – the finance and professional sectors reported high levels of access (100 percent for commerce and finance, 81 percent for professions). The services and tourism sectors were also fairly well catered for, with 71 percent and 79 percent respectively reporting adequate access. In contrast, a third of both agro-processing and industry/manufacturing businesses reported inadequate/no access to electricity, while the proportion of retailers without adequate access was as high as 41 percent.

The primary reason for poor access to water and electricity was lack of access on the specific site of the business – which accounted for 57 percent of responses among businesses with poor access to water and 47 percent for businesses with limited access to electricity. Limited infrastructure in the surrounding area was also a significant constraint on access to infrastructure, and was noted by over 40 percent of those respondents who had described their access to these services as limited. However it should be noted that a significant proportion of respondents without access

<sup>111</sup> Water, n=594, electricity, n=593, transportation, n=589, good roads

to water and/or electricity said that their access was primarily constrained by their inability to afford these services (just under 20 percent of responses).<sup>112</sup>

Businesses with informal premises were more likely to report inadequate access to infrastructure. Sixty two percent of businesses in informal premises stated that they had inadequate access to water for the purposes of running their business, compared to just ten percent of businesses in formal premises. The large majority of businesses in informal structures (77 percent) stated that they had inadequate access to water for the purposes of running their business, compared to just eight percent of those run from formal premises.

#### **12.6.5 Crime**

Mentions of crime focused mainly on theft by criminals outside the business. Crime was a more prevalent concern among Chinese-owned businesses, 54 percent of which listed crime as one of the top three problems facing their businesses. Concerns about crime declined as businesses decreased in size – while crime was mentioned as one of the top three problems by 22 percent of medium businesses, for small firms the figure was 16 percent, and for micro-enterprises only eight percent.

#### **12.6.6 Lack of finance/credit**

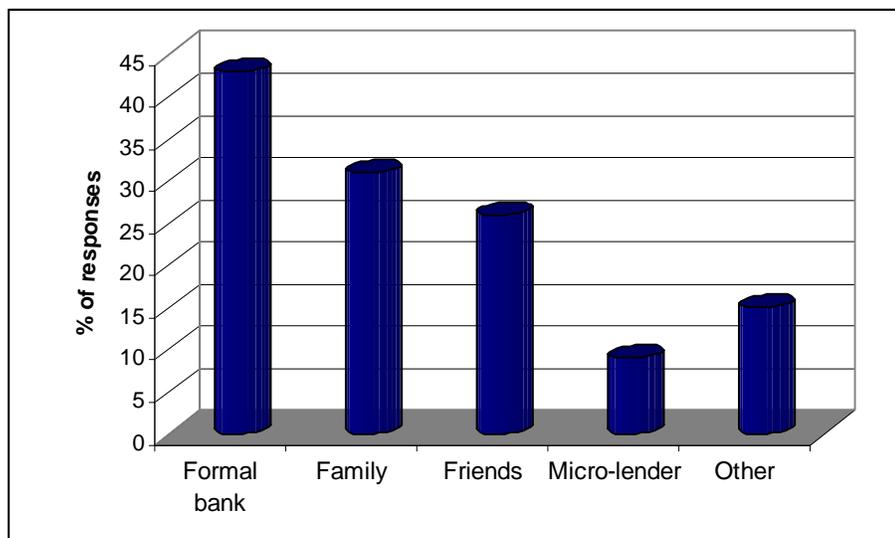
Just over half the businesses (51 percent) surveyed said that they had not accessed external finance for their business. Of those that do access finance, 43 percent said that they access finance from formal banks, whereas well over half rely on family (31 percent) and friends (26 percent).<sup>113</sup>

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<sup>112</sup> Water, n=171, electricity, n=201

<sup>113</sup> n=380. "Other" includes rotating savings/credit (4%), Machonisa (4%), Burial society (2%), Lesotho Post Bank/Post Office, LNDC, Bedco, Foreign donors, Business Association, China, Social welfare, Duran Link, Bodibu, Investment, Employer (all less than 2%).

Figure 23: Sources of finance<sup>114</sup>



Twenty-one percent of respondents stated that they had had problems accessing finance or credit from a formal financial institution. Twelve percent said that they had accessed finance from such an institution without any problems. Sixty-seven percent said they had not attempted to access finance from a formal institution.<sup>115</sup> The general perception appeared to be that it is very difficult to access credit or even an overdraft from a formal bank.

The smallest firms in the sample were much more likely to report difficulties accessing finance. Seventy one percent of micro businesses had experienced problems accessing finance, compared to just over half the small and medium businesses (56 percent and 53 percent respectively). Unsurprisingly, businesses that are registered for tax and can therefore be considered formal reported less difficulty accessing finance (56 percent) than businesses not registered for tax and therefore informal (84 percent).

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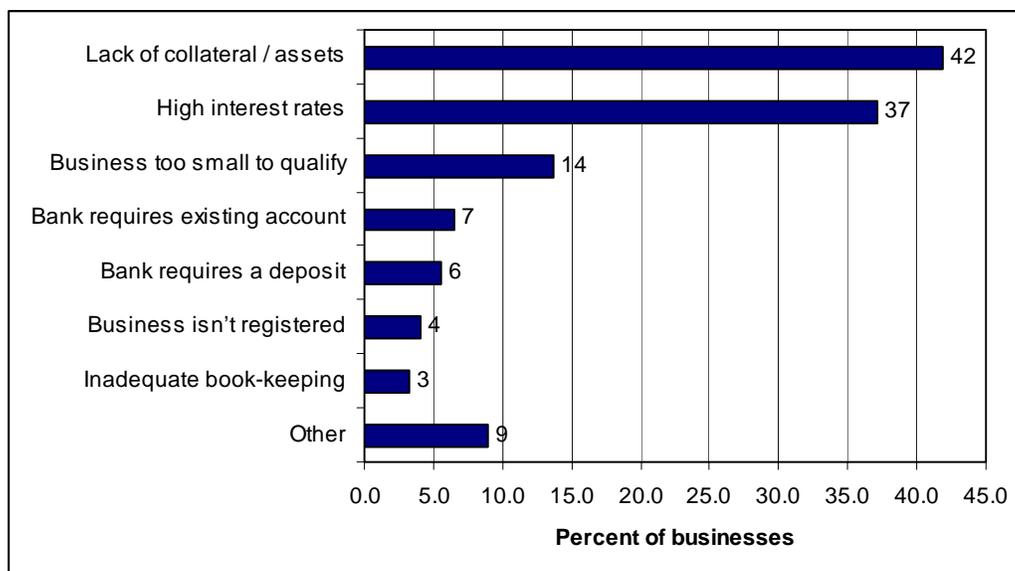
<sup>114</sup> n = 380

<sup>115</sup> n=602

Just over a third (34 percent) of businesses that are registered for tax have obtained finance from a formal bank, compared to only seven percent of businesses that are not tax-registered (i.e. informal businesses).

The most commonly mentioned factors that made it difficult for respondents to access finance from formal institutions included lack of collateral (42 percent of responses) and high interest rates (37 percent).

**Figure 24: Reasons for experiencing problems accessing finance from formal institution<sup>116</sup>**



A number of respondents noted that they use Post Bank and Bodiba Corporate Services, in preference to or in the absence of other formal banks. The Post Bank currently deals only with savings. However, the Rural Finance Intermediation Programme (part of IFAD) is working with the Post Bank to enable it to gain the legal status required to allow it to become a credit provider. The Post Bank has a far wider distribution of branches, inclusive of rural areas.

Almost a quarter of the businesses surveyed (23 percent) noted that they were concerned about the level of debt owed by their businesses.<sup>117</sup> This figure was considerably higher among commercial farmers – almost half of whom (47 percent) expressed concerns about their levels of debt.

### 12.6.7 Skills shortages

Shortage of skilled workers was mentioned by 14 percent of respondents in the highest turnover band (M1 million and over), compared to just one percent of the smallest and more survivalist businesses, which tend to be concentrated in the retail and services sectors and have limited skills requirements.

<sup>116</sup> n=129

<sup>117</sup> n=584

### 12.6.8 Regulatory issues

Lesotho scores relatively poorly on assessments of the ease of doing business, and the high proportion of enterprises in the informal economy suggest considerable regulatory barriers to formalisation.<sup>118</sup> However, the informal and survivalist nature of many of the businesses in the sample, coupled with the strong emphasis on key concerns such as market access and competition, saw very few respondents raising regulatory concerns. While informal sector enterprises might be expected to identify regulatory requirements that keep them out of the formal sector, the issue did not appear to feature highly on the agenda for the micro-enterprises in this sample.

When asked to comment on whether they find particular government regulations troublesome or difficult to comply with, 42 percent of respondents indicated that they did not know enough about regulations to respond to the question.

For businesses that did respond to the question, high tax rates – which are not strictly speaking a regulatory issue - were the most common response (mentioned by 15 percent of respondents). Other regulatory hassles included hassles created by the Maseru-based centralised system for business registration, mentioned by six percent of respondents, and difficulties obtaining licenses in order to formalise businesses, as well as perceptions that regulations favour big business or foreign (Chinese-owned) business rather than small enterprises (seven percent of respondents).

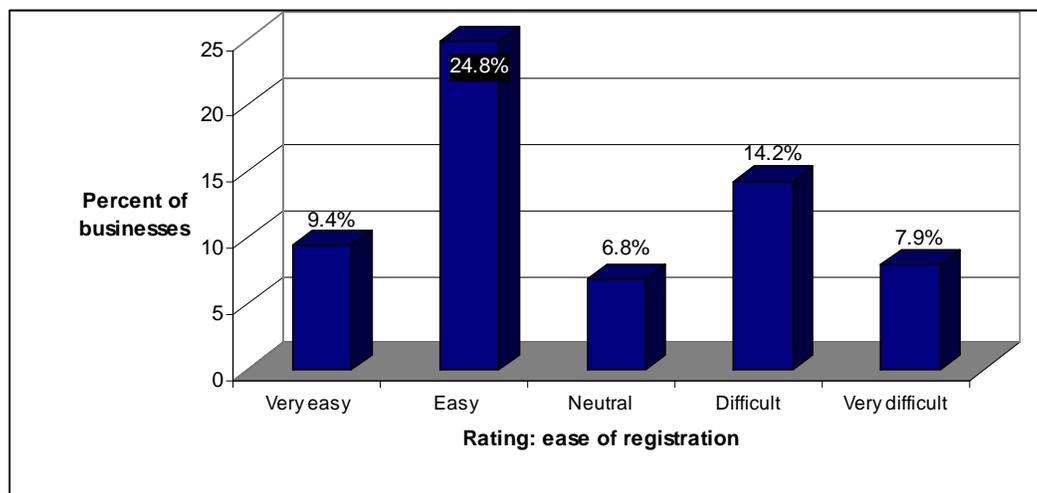
Delays created by import regulations and inefficient customs procedures were also raised by small numbers of respondents. Other issues included difficulties around obtaining liquor licenses, trading hours, harassment of hawkers and restrictive labour laws (2 to 3 percent of respondents in each case).

Respondents were asked to rate the ease or difficulty of registering their business. While 34 percent of respondents said that registering was easy or very easy, 22 percent described the process as difficult or very difficult. Anecdotal evidence from the field suggests that licensing a business for the first time is a time-consuming process, often characterised by long delays.

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<sup>118</sup> World Bank Doing Business Report, <http://www.doingbusiness.org/economyrankings/>

**Figure 25: Rating: ease of registering and / or licensing the business<sup>119</sup>**



### 12.6.9 Technology

While a large proportion of the sampled business owners (84 percent) used cell-phones in the running of their businesses, use of other basic office technology was generally low. Low levels of technology use were evident across the formal as well as informal sectors, and were also characteristic of the medium sized firms in the sample. Only 29 percent of sampled businesses had a land-line telephone, 21 percent used computers, 17 percent used a fax machine, and only 14 percent used the internet in the running of their business.<sup>120</sup>

Respondents' reasons for not accessing the types of technology listed above included the fact that such equipment/services were too expensive, that the business did not require that particular equipment or service, or that the service/equipment was not available or accessible to the business.

Unsurprisingly, tax-registered businesses reported using computers and the internet in larger numbers than did informal business. Among registered businesses, 33 percent used computers and 21 percent used the internet, compared to nine percent and six percent respectively among informal businesses. Higher proportions of businesses in the largest turnover band reported using computers and the internet (64 percent).

Businesses in the "main urban centres" and well located smaller urban centres were much more likely to use computers and the internet than businesses in more isolated areas. The education level of the business owner also showed a strong correlation with computer usage - business owners with A-level or higher qualifications were considerably more likely to use a computer or the internet.

<sup>119</sup> n=369: 171 responses were coded 'not applicable' for respondents in the informal sector who had not tried to register or license the business.

<sup>120</sup> n=609

### **12.6.10 Access to banking facilities**

Access to banking facilities was described as limited by just over a quarter of respondents – 27 percent of respondents said that they had inadequate access or no access to banking facilities in the vicinity of their business operations.<sup>121</sup> This proportion was lowest in the Northern and Southern Lowlands Zones (13 percent and 24 percent respectively). These zones include larger towns such as Maseru, Butha Buthe, Leribe and Mafeteng, which offer formal banking facilities to businesses. In contrast, 40 percent of respondents in the Mountains zone and 52 percent in the Foothills reported having inadequate access to banking facilities. Sampled areas in these zones were limited to small urban centres and isolated rural settlements, which would be much less likely to have formal banks operating within accessible distance of the surveyed businesses. While lack of facilities was a key factor in limiting access to formal banking (mentioned by 61 percent of respondents who reported that they did not have access), perceptions that such services are unaffordable also played a large role – cost was mentioned by 40 percent of respondents as the primary reason for their lack of access.

Only 21 percent of businesses run from formal premises reported difficulty accessing banking facilities. The large majority of these (78 percent) said that banking facilities were absent or very limited in their area of operation. In contrast, almost half the businesses operating from informal premises (48 percent) reported that they had inadequate access to banking, but this was mainly because the services were unaffordable (58 percent).

Bank charges were generally perceived as being quite high, and business owners complained that they incur such charges whenever they deposit or cash a cheque. There were also a number of complaints about the long queues in banks. Respondents noted that cell phone and internet banking are still very new in Lesotho, and anecdotal evidence suggests that they are not yet fully implemented and/or widely used.

Qualitative interviews with small businesses revealed differences in transaction times and processes for the different banks inside Lesotho, and between Lesotho banks and those over the border in South Africa. If respondents want to cash a cheque and receive funds immediately, they tend to travel to a bank in South Africa. It was reported that Lesotho banks take 1 to 2 weeks to clear a cheque. The exception is FNB, which operates in both Lesotho and South Africa, allowing cheques to be immediately processed if both payee and receiver are with FNB.

Similarly, if a small business is paying a supplier by cheque, if the supplier is with FNB, the business can deposit the money in Maseru and the supplier will receive the funds very quickly. If the person is paying suppliers in South Africa who bank with any other bank, however, it is better for him to cross over to South Africa and deposit the money in a bank there, in order to speed up the process and minimise his bank charges. This

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<sup>121</sup> n=589

can however represent a big cost in terms of time spent at the border by the business owner.

A transaction that involves depositing money in Lesotho to pay a South African company incurs inter-country bank charges (with the exception of FNB which operates in Lesotho and South Africa and bank charges are therefore minimised). If a business person is depositing money in a South African bank he must also ensure that he has Rand rather than Maloti to deposit, otherwise he will incur charges for currency exchange.

Anecdotal evidence suggests that small businesses tend not to keep separate accounts for business and personal use.

Poor access to banking facilities outside Maseru is of concern for the tourism industry. The Bureau de Change is located only in Maseru, and there is limited access to credit card facilities outside the city. Not all urban centres offer ATMS.

#### **12.6.11 Business linkages**

Across the sample, the integration of small businesses into supply chains appeared to be largely lacking. Only three percent of respondents said that they provide goods or services to big businesses in Lesotho or to the South African market.<sup>122</sup>

This small sub-sample of respondents was asked to describe how they go about accessing these markets. Two-thirds said that they rely on formal linkages with larger businesses. Seventeen percent said that they engage in informal trading of goods or services, and a further ten percent said that they have informal arrangements with larger businesses. The extent of informal arrangements (a third of the sub-sample) suggests further limitations to the scope of cross-border trading and business linkages. Only a very small number of respondents in the sub-sample reported having direct access to other markets through export, and a similarly small number said that they access big business contacts or external markets through local business chambers of associations (three percent in each case).

#### **12.6.12 Impact of HIV/ Aids on business**

The majority of respondents (64 percent) said that HIV/Aids had no impact on their business. Twenty-two percent said that they were experiencing some or large impact as a result of the disease. Fifteen percent reported little impact, while 7 percent reported a very large impact.<sup>123</sup> Analysis of responses by size of business showed that larger enterprises report a larger impact as a result of HIV/AIDS.

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<sup>122</sup> Defined in the survey as those with 50 or more employees

<sup>123</sup> n=603

**Table 9: Impact of HIV/Aids against business size (annual turnover)<sup>124</sup>**

| Impact            | Under M200 000 | M200 001 - M1 million | Over M1 million |
|-------------------|----------------|-----------------------|-----------------|
| Very large impact | 3%             | 1%                    | 24%             |
| Large impact      | 10%            | 13%                   | 14%             |
| Little impact     | 15%            | 19%                   | 10%             |
| No impact         | 65%            | 63%                   | 48%             |
| Not sure          | 8%             | 5%                    | 5%              |

Among those businesses who reported that HIV/AIDS had a large or very large impact on their business, the primary concern was illness and death among customers – reducing an already limited market for goods and services (65 percent of the sub-sample responses). Fourteen percent said that the ill health of their employees was a key reason for the large impact of HIV/AIDS on their business. Thirteen percent of respondents noted that the business provides services for clients with HIV/AIDS (respondents included funeral homes and insurance companies, for example).<sup>125</sup>

## **12.7 Awareness of and access to business support**

### **12.7.1 Knowledge and use of BDS**

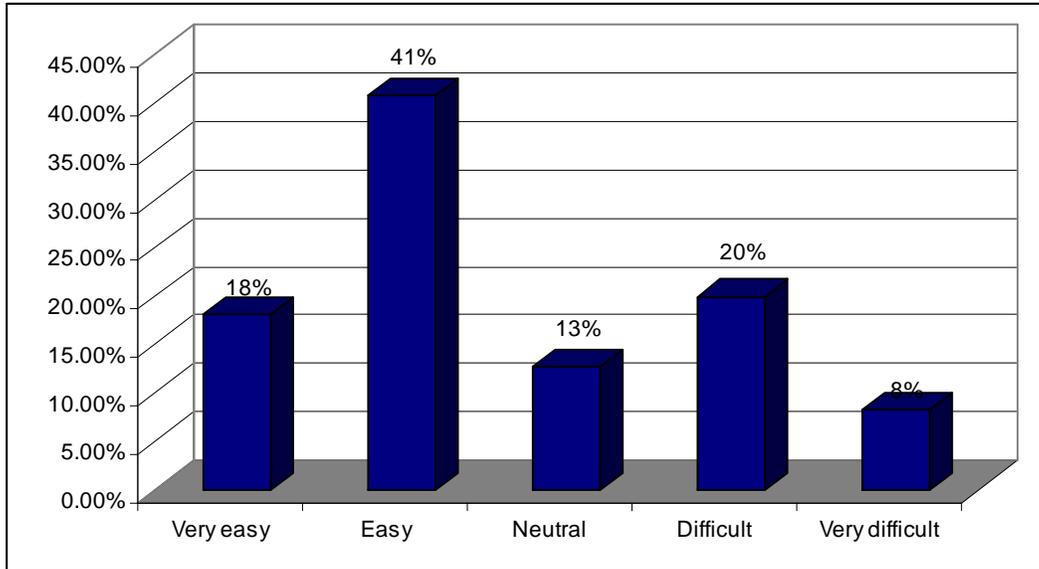
Respondents were asked to rate the ease with which an individual is able to obtain advice on starting or running a business. Sixty-one percent of respondents said that such advice was easy or very easy to obtain, while 20 percent said that it was difficult and eight percent very difficult.

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<sup>124</sup> n=563

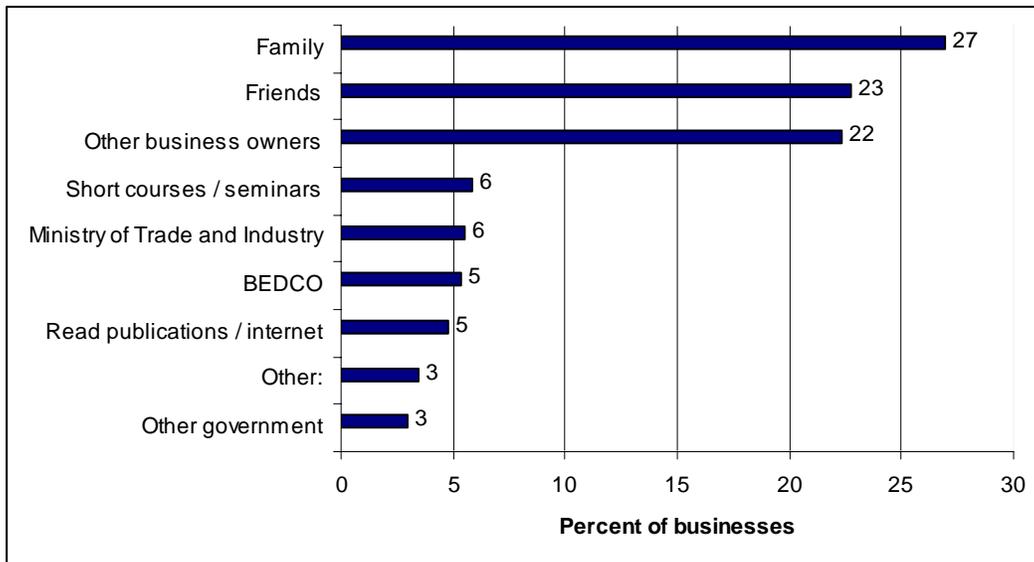
<sup>125</sup> n=82

**Figure 26: Ease of access to advice on starting or running a business<sup>126</sup>**



It should be noted that the large majority of respondents relied on informal sources of advice such as family (27 percent), friends (23 percent) and other business owners (22 percent) - rather than official sources of advice such as business development service providers or government agencies.

**Figure 28: Source of advice obtained on starting or running the business<sup>127</sup>**



Government agencies mentioned as sources of advice and support included MTICM, BEDCO, and LNDC. Only two respondents mentioned the one stop shop in Maseru.

<sup>126</sup> n=566.

<sup>127</sup> n=604

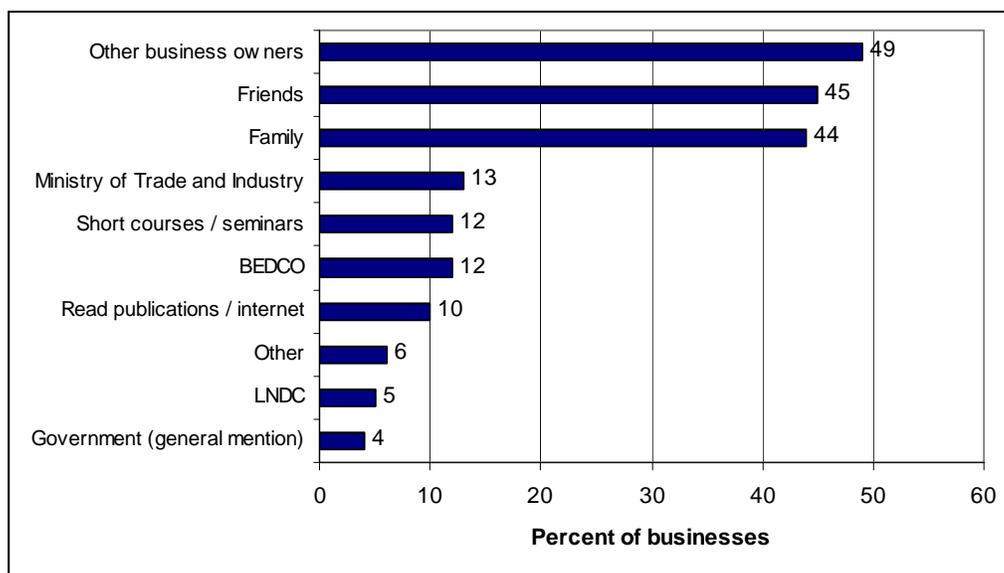
Small numbers of respondents also mentioned various other district and national government departments.

Sources of advice mentioned by respondents did not show any significant variation across Livelihood Zones – suggesting that businesses in Maseru with ready access to national government departments and the one stop shop do not necessarily make greater use of these resources than businesses in areas further afield.

Micro and small businesses were less likely to access formal sources of support compared to medium businesses, tending to rely largely on advice from family, friends and other business owners.

The survey sought to probe further to find out whether businesses were aware of possible sources of support and advice that they were not necessarily accessing. Asked about possible sources of advice, the most common responses were again friends, family and other business owners (mentioned by over 40 percent of respondents). Thirteen percent of respondents suggested that the MTICM could be a source of advice, twelve percent suggested BEDCO, five percent LNDC, and 4 percent made general mentions of government. Interesting, there were only two mentions of the one-stop shop, and respondents were far more likely to look to their own contacts, as well as short courses and independent reading for advice than they were to government services.

**Figure 29: Possible sources of advice on starting or running a business<sup>128</sup>**

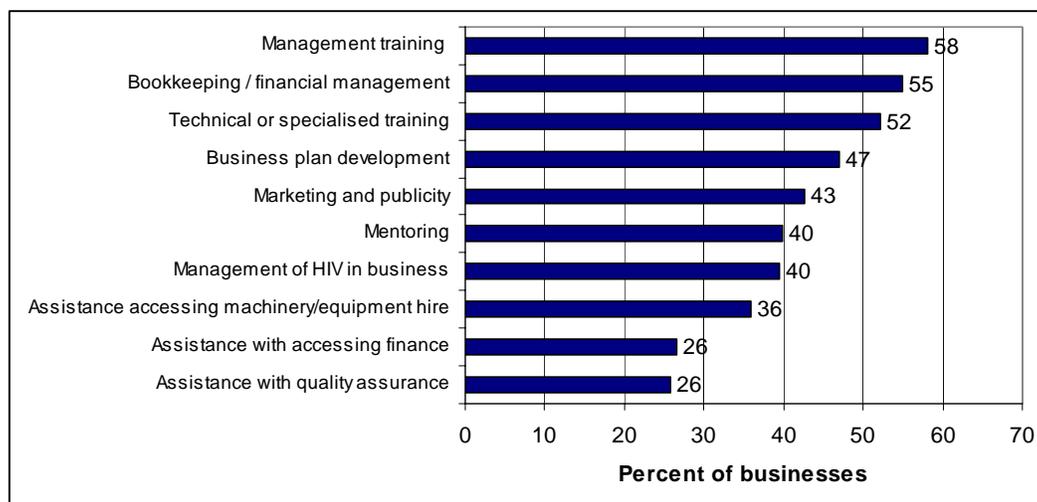


<sup>128</sup> n=568. 'Other' includes Banks and Financial Institutions 9 (responses), Business Chambers/Associations (5 responses), services provided outside Lesotho (4 responses), Universities and colleges (3 responses), One Stop Shop in Maseru (2 responses), Specific projects and programmes (3 responses), Business consultants (2 responses), Lawyer/auditor, LRA, ancestors, LMPS and the radio (1 response each).

Respondents were provided with a list of business development services,<sup>129</sup> and asked if they had ever accessed any of the listed services. Fifty-eight percent of businesses said that they had never accessed any BDS, while 42 percent had used at least one such service.

Management training, book-keeping/financial management, and specialized training were the most commonly accessed forms of BDS – mentioned by over half the sub-sample that had accessed BDS.<sup>130</sup>

**Figure 30: Percentage of businesses that have used BDS by type of BDS used**



Respondents referred to a very wide range of sources from which BDS had been accessed. These included national agencies such as BEDCO, Business Chambers, LCCI and LNDC, as well as more local BDS suppliers such as Maseru Business Management and Smart Project, and government agencies including MTICM and Lesotho Revenue Authority. However they also included less obvious sources of BDS, including banks, various universities and business and training colleges (in Lesotho and South Africa), as well as informal advice from friends and on-the-job training in formal employment. Given that a large proportion of responses referred to these very unofficial sources of BDS, it should be noted that access to *formal* BDS (as provided by a relevant government body or professional private sector provider) is likely to be well below the 42 percent figure reported by respondents.

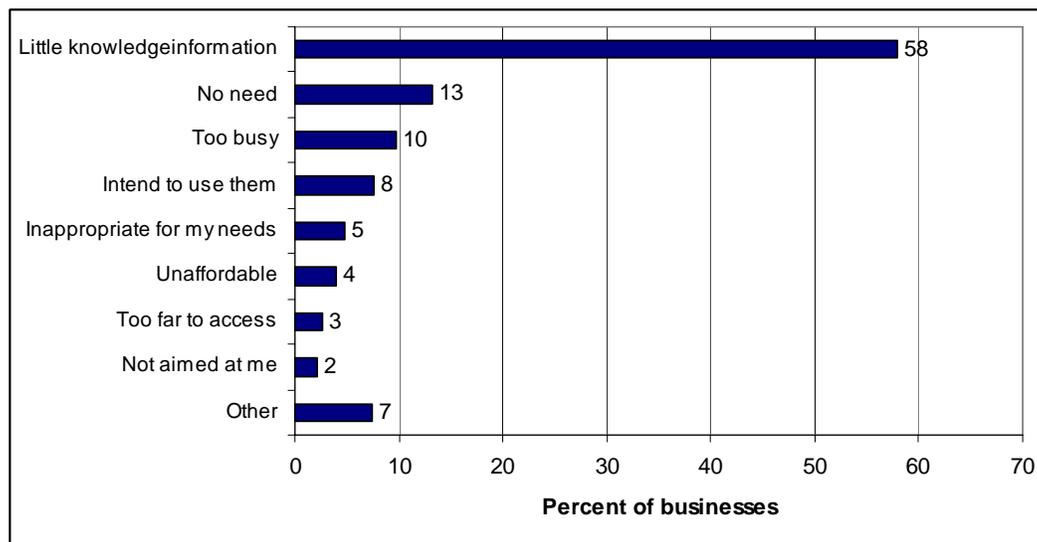
All respondents were asked to identify barriers for small businesses in accessing BDS. Lack of knowledge or information about BDS was by far the most commonly mentioned barrier, cited by almost 60 percent of respondents. The second most common response (although accounting for only 13 percent of responses) was simply that the business felt no need of BDS. Ten percent of respondents said they were too busy to

<sup>129</sup> Management training; Business plan development; Assistance with accessing finance; Assistance with accessing machinery and equipment hire; Technical or specialized training; Mentoring; Book keeping or financial management; Management of HIV in the workplace; Marketing and publicity; Assistance with quality assurance

<sup>130</sup> n=253

access such services, while 5 percent assumed that they would not be appropriate for their particular needs.

**Figure 31: Reasons for not utilizing Business Development Services<sup>131</sup>**



## 12.8 Priorities for government support

Respondents were asked to mention the most useful thing that government could do in order to improve the environment for small businesses. While larger and/or more sophisticated businesses identified a number of issues on which government might reasonably be expected to engage, the smallest businesses in the sample tended to make some fairly unrealistic suggestions, which mainly involved accessing cash with very few strings attached.

Access to finance was mentioned by 29 percent of businesses in the sample, and was by far the most frequently mentioned area in which businesses would like assistance. These mentions however included a high proportion of requests for direct cash assistance from government, rather than more constructive suggestions in respect of accessing loans and credit facilities.

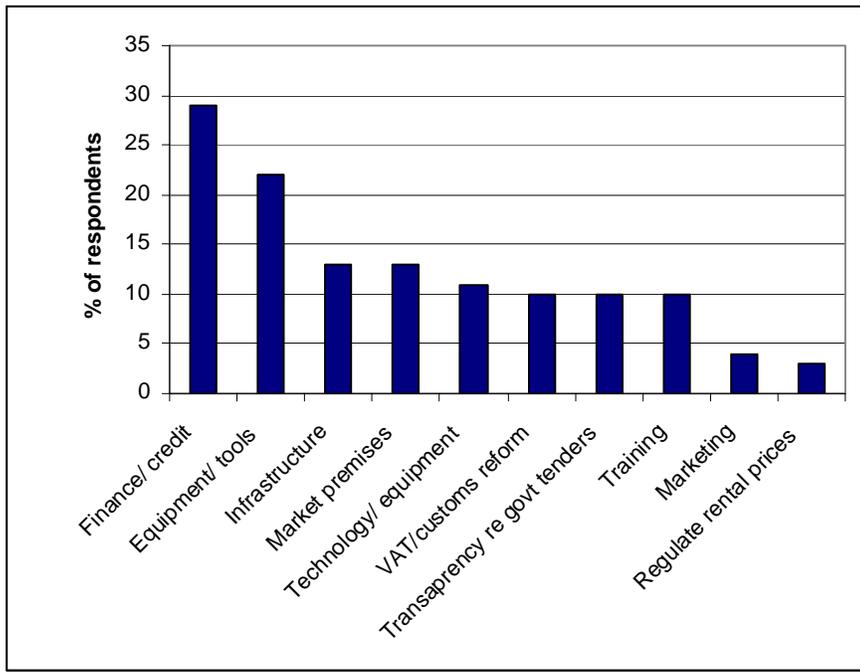
Improved access to reliable infrastructure was the second most frequently mentioned issue, and included access to electricity and water (13 percent of respondents). Infrastructure was particularly prioritised by businesses in more remote locations, such as Quthing and Mokhotlong, where it was mentioned by over 20 percent of respondents (compared to only seven percent of respondents in Maseru).

Thirteen percent of respondents wanted the government to provide premises and facilities for market-places that could be used by small businesses – this response was particularly prevalent among small retailers.

<sup>131</sup> n=576

Other areas of support mentioned by respondents included improved access to technology and or equipment for the business, including tools and capital goods (22 percent of respondents), regulatory reform in the area of VAT administration and customs procedures (ten percent of respondents) and greater access to, and transparency in the issuing of, government tenders (nine percent of respondents). Small numbers of respondents also asked for support in terms of training for small businesses. Preferences in respect of training included book-keeping and financial management, management training, sector specific training, marketing and assistance developing business plans.

**Figure 32: Areas of support requested from government<sup>132</sup>**



<sup>132</sup> n=564