



Pathways to addressing informality of baobab enterprises in Malawi

William Dumenu & Dietrich Darr

Key message

- Informal enterprises are a pervasive feature of the Malawian baobab industry
- Costly entry regulations, lack of support to access the benefits of formalization, less equitable tax structure, and less inclusive financial system are some of the causes of informality in the baobab industry
- To reduce informality and promote firm formalization, policymakers should implement costless registration, promote financial inclusion, invest in skill development and entrepreneurship, etc.

What is the issue?

The emerging baobab processing industry has huge economic potential and offers the opportunity to diversify the rural economy of Malawi through livelihoods and income generation. The demand for baobab products is increasing not only locally but internationally. Brands (e.g. Coca-Cola, Innocent Smoothies) incorporating baobab in their food and beverage products have experienced 53% annual growth¹. The continuous performance and growth of the industry depend on the productivity of the enterprises involved in the processing and marketing of baobab products.

The Malawian baobab processing industry is highly dominated by informal micro and small enterprises. The pervasiveness and prevalence of informal enterprises undermine the performance, growth, and development of the industry (e.g., productivity, access to the global market, access to finance), government revenue (e.g. tax collection), and development (e.g. employment generation).

This policy brief aims at identifying the causes of firm informality, and provide actionable recommendations for policymakers to address informality in the Malawian baobab industry.



Research approach

The study draws on the experiences of baobab processing entrepreneurs and employs Q-methodology to assess their perspectives on the causes and measures that can help reduce informality and drive formalization among micro, small, and medium baobab enterprises. The entrepreneurs constitute a

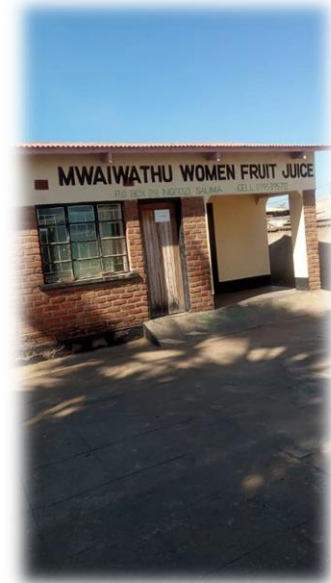
¹ GIZ, SECO and KSA. 2021. How the baobab industry developed from emerging and maturing sector. AbioSA Case Study Report, GIZ.

rich source of practical insight in addressing informality considering several years of operating in the informal sector.

Key findings

Causes of informality

- **Costly entry regulations**
Business registration fee is expensive, particularly for micro and small businesses, and the process is tardy.
- **Lack of support to access the benefits of formalization**
No support or assistance for firms to access the benefits of formalization (e.g. opening a business bank account, access to finance, etc.).
- **Less equitable tax structure**
The credit system of value-added tax (VAT) prevents firms that transact with unlicensed suppliers (main producers of baobab) from accessing credits thus, creating a vertical transmission of informality.
- **Less inclusive financial system**
The majority of micro and small businesses are unbanked, less financially literate, and have limited access to digital financial services. Also, lack of access to credit and insurance drives firm informality.
- **Low institutional and governance quality**
Lax enforcement of business regulations and laws; and poor delivery of public goods and services.
- **Low level of economic development**
Limited formal job opportunities thus, the establishment of informal micro and small businesses for livelihood and income.



Policy recommendations

- ❖ Implement costless business registration for micro, small, and medium baobab enterprises combined with information on the benefits of formalization.
- ❖ Promote financial inclusion and access to credit through the establishment and operation of microfinance services with tailored products, digital medium of exchange, and store of value using mobile money accounts in addition to traditional bank accounts.
- ❖ Develop and implement programs to increase financial literacy among informal workers helping them understand banking services, savings, and investments.
- ❖ Invest in vocational training programs, skills development, and entrepreneurship to equip informal baobab entrepreneurs with relevant skills to enable transition into formal employment or improve the productivity of their businesses.
- ❖ Consider the implementation of tax substitution that applies tax at some stage in the production particularly if the production chain involves large firms transacting with smaller firms. The large firms which cannot afford to be informal pay the tax (e.g. VAT) leaving the smaller firms in the same production chain with a lower cost of formality.

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