

Impact Evaluation of the “*entreprenant* status” in Benin

Methodology Note¹

Draft – October 31, 2013

1. Background

Prior to creating the *Organisation pour l'Harmonisation en Afrique du Droit des Affaires* (OHADA) in 1993, the current seventeen member countries had similar business laws.² In 1993, they decided to harmonize them through the creation of the OHADA. Today, there are nine OHADA Uniform Acts in force, including those concerning the company law, the secured transaction law, the insolvency law, and the commercial law).

Following technical assistance provided by the WBG and other donors, OHADA member countries adopted a revised General Commercial Law in December 2010, which came into force in May 2011.

Among other provisions, the new General Commercial Law introduced the legal framework for the “*entreprenant* status,” a simplified legal regime specifically designed for small entrepreneurs, whose intended objective is to facilitate the migration of businesses operating in the informal sector into the formal sector. However, the law does not mention the specific combination of incentives that will be included in the *entreprenant* status (for example, tax, credit, business registration, social security benefits), allowing instead each country to fill in the vacuum through ad-hoc secondary legislation. Benin, a member of OHADA, is currently implementing the legal and administrative regulation that will define the *entreprenant* status, with support from the WBG.

2. Informality in Benin

In Benin, about 90% of the population works in the informal sector. According to the national statistics office, the informal economy accounts for 60-70% of Benin’s GDP. About 98% of all firms are owned by individual entrepreneurs, and half of the firms have a capital stock lower than USD 1,000 (and the capital does not exceed USD 2,500 for almost all the firms). See Annex 1 for additional details on the informal economy in Benin.

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² OHADA member countries include Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Comoros, Republic of the Congo, Côte d'Ivoire, Equatorial Guinea, Gabon, Guinea, Guinea-Bissau, Mali, Niger, Senegal, Togo, and Democratic Republic of Congo.

A short survey of small businesses at the Dantokpa market in Cotonou revealed that “informality” is not a univocal concept for microentrepreneurs.³ In fact, a significant fraction of individual firms operating in localized places are known by the public administration and pay taxes, and some of them have access to credit (through microfinance institutions). But the vast majority of entrepreneurs run their business without any formal status.

The survey showed that informality varies from having no interactions with the State (paying no taxes, having no legal status) to having temporary registration with the Ministry of trade and industry (though not formally registered at the *registre de commerce*), and to paying some taxes (though without any tax identification number). See Annex 2 for additional details.

Understanding the effect of different ways to implement the *entreprenant* status is a critical issue to introduce the right policies for promoting formalization.

3. Impact Evaluation (IE) of the *entreprenant* status

The *entreprenant* status, as formulated by the OHADA law, is a legal status that can apply to a physical person running a small business, who practices any type of activity (civil, commercial, artisan, agricultural),⁴ and with limited turnover.⁵

The ongoing implementation of the *entreprenant* status offers the ideal conditions to study the impact of different packages of incentives on formalization decisions, the legal environment in which firms operate, and how businesses interact with public authorities. Also, it can show the impact of different firms and entrepreneur characteristics as determinants of formalization, and whether specific incentives carry any tangible benefits for the firm and its growth prospects.

The shift from a registration process to a simple declaration should simplify the procedures by reducing the number of steps required to formally operate. In addition, the declaration will be free of charge, unlike the registration procedures that are currently required for business start-ups.

There is also the perception that becoming formal and having a tax and registration identification number should improve the credit risk of the business and its chances to obtain credit. At the same time, facilitating small enterprises’ compliance with tax obligations should be considered by businesses as an advantage with respect to the current convoluted tax system. The impact evaluation will test the effect of increasing the predictability of what newly formalized

³ The Dantokpa market is the largest market in West Africa. See <http://www.fao.org/docrep/003/AB787F/ab787f07.htm>.

⁴ This is one the main difference between an “individual entrepreneur” and the *entreprenant*: the individual entrepreneur can practice only a commercial activity.

⁵ Article 30, paragraph 2, of the OHADA General Commercial Law defines the *entreprenant* as having an annual turnover below FCFA 30 million for trading activities, CFCA 20 million for crafting activities (artisans), and CFCA 10 million for services. However, paragraph 4 of the same article says that member countries are free to determine the maximum turnover of the *entreprenant*. Accordingly, those thresholds need to be considered indicative, and member states are free to adopt different thresholds. Benin is considering fixing this threshold at FCFA 40 million, which is the threshold of the current small business tax regime. The *entreprenant* status should also include a reduction of registration costs and time.

businesses will pay, and offer them protection during inspectors visit. Business will be able to call a Tax Mediator and for any complaint and show inspectors tax declaration certified (“stamped”) to be complying with the rules.

The extent to which businesses will actually perceive these benefits as real is unclear and it will be verified through the impact evaluation. The packages of incentives offered to two groups of small informal businesses will try to directly reduce the concerns that firms may have about formalizing. Specifically, the impact evaluation will analyze the impact that different packages of incentives have on the following outcomes: formalization rate, firms’ performance, tax payments, and access to credit.

Ideally, after the results of the impact evaluation, the government will scale up the more successful incentives in the form of the *entreprenant* legal status to all firms.

4. Background literature and theory of change

The key assumption of the *entreprenant* status is that it will encourage formalization by making business registration and operations simple, cheap and fast. Much of the literature has focused on easing business start-up regulations, and it has found that large improvements in the ease of start-up are associated with more companies registering.⁶

There is less evidence on the formalization of smaller enterprises. A reform in Mexico, which was implemented in some of the most populous and economically developed municipalities starting in 2002, reduced the number of days taken to start a business from 30.1 to 1.4. Bruhn (2011) used data on individuals’ employment status from the Mexican Labor Market Survey (ENE) to show that this reform increased the number of registered business owners by 5 percent.⁷ However, recent information campaigns following simplification of registration requirements have resulted in very few informal firms registering.⁸

At the same time, there may be incentives other than easing the regulations to register that could attract the informal sector into formality. For instance, the main drawback firms typically see from formalizing is the taxes they expect they will have to pay. In most countries, informal firms view tax revenues as minimally beneficial to themselves, their families or their community. They also worry about the risks of harassment from inspectors.⁹ To our knowledge, there is no empirical evidence of the effect of tax mediation/protection which would directly address these

⁶ Klapper, Leora and Inessa Love. 2010. “The impact of business environment reforms on new firm registration”, World Bank Policy Research Working Paper no. 5493.

⁷ Bruhn, M. (2011): “License to sell: the effect of business registration reform on entrepreneurial activity in Mexico” *Review of Economics and Statistics*, 93(1): 382-86.

⁸ See Andrade, G. H., Bruhn, M., McKenzie, D. (2013): “A helping hand or the long arm of the law? Experimental evidence on what governments can do to formalize firms”, Mimeographed. World Bank; De Mel, S., McKenzie, D., Woodruff, C. (forthcoming): “The demand for, and consequences of, formalization among informal firms in Sri Lanka”, *American Economic Journal: Applied Economics*; and De Giorgi, G., Rahman, R. (2013) “SME’s Registration: Evidence from an RCT in Bangladesh”, Mimeographed. Stanford University and World Bank.

⁹ See, for example, De Mel, S., McKenzie, D., Woodruff, C. (2013): “The demand for, and consequences of, formalization among informal firms in Sri Lanka”, *American Economic Journal: Applied Economics* 5(2): 122-50, and Jaramillo, M. (2009): “Is there demand for formality among informal firms? Evidence from microfirms in downtown Lima”, *German Development Institute Discussion Paper* 12/2009.

issues. This aspect of the “entrepreneur” program which will explicitly look at this question of tax mediation/protection is therefore very important.

While formalization itself is an outcome of interest, this study will attempt to uncover the channels by which formalization may improve firm performance. First, bank financing is often hypothesized as one of the major channels through which formalization can improve firm performance, yet randomized experiments measuring formalization in Sri Lanka and Brazil have recorded no significant increase in the number of bank credits awarded to firms becoming formal. One possible reason is that newly formalized firms require more than just their formal certification, but also facilitation and access to banks. This access to credit is important as McKenzie and Woodruff (2008) demonstrate. Using evidence from Mexico they show that relieving credit constraints leads to increased returns to capital of 20-30%, on average, and 70-79% among those firms that reported being financially constrained.¹⁰ Hence, offering firms much more hands-on support in accessing bank financing could make formalization much more attractive and beneficial to firms.

Second, formality may offer small firms the ability to pool risk, thus attracting more educated workers who engage in longer term relationships with the firm. This, in turn, makes training and capital acquisition more profitable. Additionally, formalization may incentivize businesses to invest in a fixed locale, permitting expansion of capital and employment. Fajnzylber et al. (2011) examine these channels in an evaluation of Brazil’s formalization program, SIMPLES. They find that the large increases observed in firm performance due to formality may indeed be driven by these factors. They find that formality increases firm employment by 40-50% and increases the probability of having a fixed location by a 30-50%, leading to large increases in revenues and profits.¹¹ Similarly, in Viet Nam, firms that decided to formalize in the period 2007-2009 saw an increase in their profits and investments compared to similar firms that remained informal.¹² McKenzie and Sakho (2010)¹³ find evidence in Bolivia that firms which become formal issue more tax receipts and have greater sales. De Mel et al. (2013) find that firms in Sri Lanka are more likely to advertise, while Bruhn and McKenzie (2013) highlight that the literature shows that formalizing may help firms to expand their customer base.¹⁴ These studies underline the fact that these and other important channels may exist by which firms interact with formalized status to attain higher performance.

Finally, one important limitation in the existing literature on both the effect of entry regulation on formalization, and the effect of formalization on performance, is its focus on evidence from

¹⁰ McKenzie, D., and Woodruff, C. (2008). “Experimental evidence on returns to capital and access to finance in Mexico.” *The World Bank Economic Review*, 22(3), 457-482.

¹¹ Fajnzylber, P., Maloney, W. F., and Montes-Rojas, G. V. (2011). “Does formality improve micro-firm performance? Evidence from the Brazilian SIMPLES program.” *Journal of Development Economics*, 94(2), 262-276.

¹² Rand and Torm (2012), “The Benefits of Formalization: Evidence from Vietnamese Manufacturing SMEs,” *World Development* Vol. 40(5), pp.983-988.

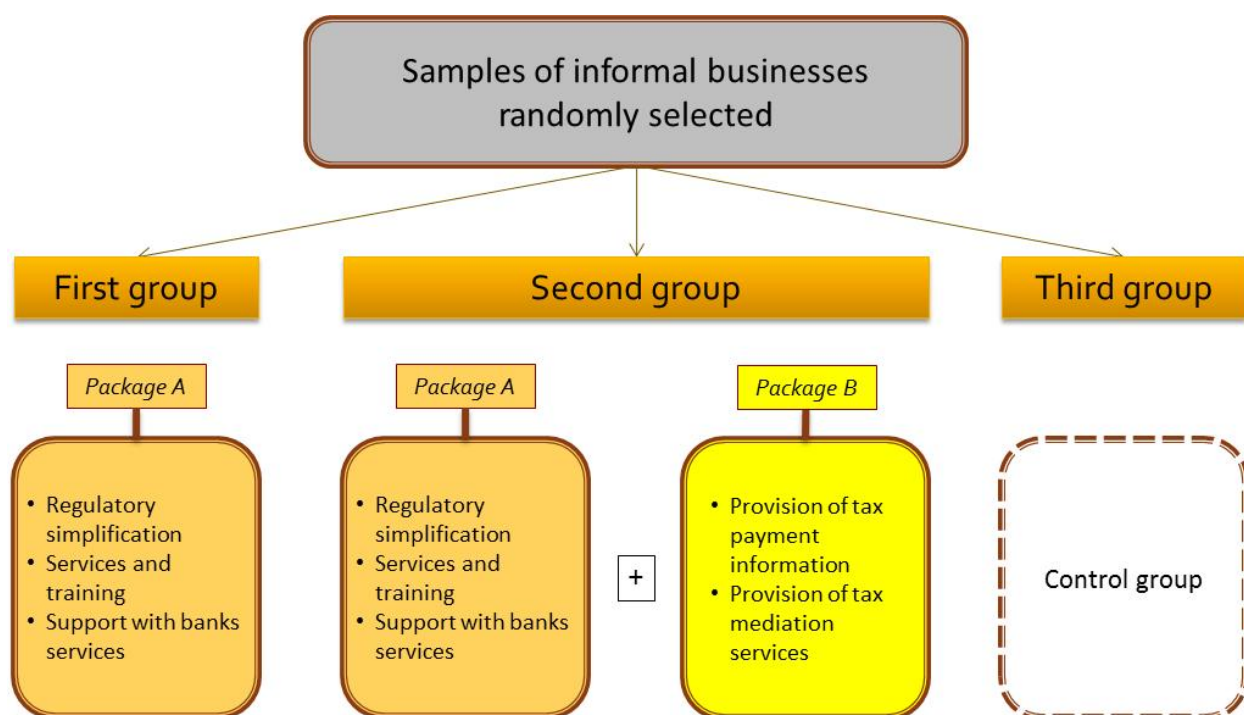
¹³ McKenzie, D. Sakho, Y.S. (2010): “Does it pay firms to register for taxes? The impact of formality on firm profitability”, *Journal of Development Economics* 91(1): 15-24.

¹⁴ Bruhn, M., McKenzie, D. (2013): “Entry Regulation and Formalization of Microenterprises in Developing Countries”, World Bank Policy Research Working Paper 6507

Latin America and Southeast Asia. The impact evaluation of the “entrepreneur” status in Benin will provide rigorous evidence on the impacts of formalization in an African context.

5. IE identification strategy

This impact evaluation tests the following two packages of formalization incentives. A third package of health benefits may be included at a later stage of the project.¹⁵



Package A of incentives will be offered to all informal businesses randomly selected in group one and group two. It includes the following components:

- Regulatory simplification: a streamlined business registration process, including a reduction in number of steps, time and cost to register;
- Services and training: training will include basic accounting and firm management; services will include support to entrepreneurs in the formalization process and, for example, help in drafting financial statements and business plans;
- Support with bank services: creation of a bank account (checking or saving) with a commercial bank.

The **first group** of firms will only receive *Package A* of incentives. A subgroup may also receive, at a later stage, support to obtain a commercial loan.

¹⁵ This package would include medical insurance to guarantee access to various healthcare services at an attractive price. The evaluation would measure the extent that having access to medical insurance at an “affordable” price (which is not available for informal entrepreneurs) can constitute a strong enough incentive to formalize.

Package B of incentives includes the following components:

- Provision of tax information and support: information on the (new) tax system, support on preparing and certifying the tax declarations;
- Provision of tax mediation services: safeguards against arbitrary practices from the tax administration, and mediation services between *entreprenants* and the tax authority.

The *second group* of firms will receive *Package A* and *Package B*.

A *third group* of firms, the control group, will not receive any incentives to formalize. All groups will be randomly selected.

The rationale of the interventions detailed in packages A and B follows directly the discussions held with the Government and the private sector (formal and informal). The Government is keen to assess whether simplifying entry procedures, and providing access to services and financial services (including credit), has any effects on formalization rates. Package A of incentives contains both types of services.

At the same time, the current tax system for micro businesses is very uncertain in Benin. Businesses are not able to assess the taxes they will pay (due to a lack of transparency of the tax regime and tax practices), and regulations and exemptions to tax payments are not consistently applied among various categories of formal and informal businesses that operate inside or outside the formal markets. Informal businesses report of ongoing negotiations that occur when they face the tax authorities and pay their recurrent dues. Hence, since there is no systematic penalty applied to informal firms, the current tax practice offers a strong incentive to businesses to remain informal (and informal businesses have a high probability of evading taxes).

The Government is currently discussing a new simplified tax regime for micro and small enterprises, which should address those concerns and introduce more certainty in the amount of tax payments. As part of the implementation of the *entreprenant* status in Benin, the WBG will offer support to the government in the design and implementation of the new tax regime.

Many implementation details described in the coming chapters are still unclear and the design of the impact evaluation can be further detailed.

See Annex 2 and 3 for additional details on the current tax system that applies to small entrepreneurs.

An alternative IE identification strategy that the team is currently exploring would modify the interventions to the various groups in the following way:

- Group A1: regulatory simplification information + tax payment information - sample size 450 - purpose: just to see if information alone is enough in this context to get registration
- Group A2: A1 + business training + bank service support - sample size 1,350 - purpose - dual purpose of seeing whether offering some benefits linked to formalizing brings firms into the formal sector, plus getting enough firms to formalize to use for seeing what the impact of

formalizing is on the firms (of course the difficulty here is that we will get the combined impact of being formal + getting trained + getting access the banks)

- Group B: Group A2 + provision of tax mediation services - sample size 1,800
- Total informal businesses to sample = 5,400

5.1. Package A - Regulatory simplification (Implementing entity: GUFÉ)

The *entreprenant* will not be requested to register as a business: it will just declare itself at the GUFÉ (*Guichet Unique de Formalisation des Entreprises*, i.e. the one-stop shop for business formalization).¹⁶ The GUFÉ set the cost of registration of the *entreprenant* in FCFA 10,000 (approx. USD 21), which include the issuance of the *entreprenant* card.

As a result, the following costs included in the current process of business registration will be eliminated:

- FCFA 25,000 (one-time registration fee to the *Chambre de Commerce et d'Industrie du Bénin*, CCIB)
- FCFA 10,000 (first year registration fee to the CCIB)
- FCFA 5,000 (registration fee to the *Registre de Commerce et de Crédit Mobilier*, RCCM)
- FCFA 5,000 (cost of legal publication)
- FCFA 5,000 (cost for the issuance of the trade card)
- Registration costs to the GUFÉ

The process of registration of the *entreprenant* will also reduce the time and number of registration steps. Following are the main steps:

1. The entrepreneur will present to the GUFÉ the declaration form duly completed and signed, and the required accompanying documents:
 - Copy of the identity card, or LEPI (*Liste Electorale Permanente Informatisée*) card, or any administrative document proving the identity;
 - Copy of the extract of birth certificate;
 - Signed affidavit attesting that the applicant is has not been banned by any Court to engage in commercial activities (the affidavit must be completed within 75 days of the Court's inquiry);
 - Photo ID.

The *entreprenant* must present the original documents to permit the verification of authenticity of the copies.

2. GUFÉ officials validate the application and the supporting documents, and process the registration with the:
 - RCCM
 - DGID (tax authority)

¹⁶ According to article 62 of the OHADA General Commercial Law: "L'entreprenant déclare son activité avec le formulaire prévu à l'article 39 ci-dessus, sans frais, au greffe de la juridiction compétente ou à l'organe compétent dans l'Etat Partie, dans le ressort duquel il exerce."

The GUFÉ will also share information with the Department of Labor (*Direction générale du travail*) and the Ministry of Commerce (*Ministère du commerce*).

3. The procedure will conclude when the entrepreneur goes back to the GUFÉ, less than a day later, to receive:
 - The *entreprenant* card, which constitutes proof of the registration;
 - An acknowledgment statement specifying their RCCM and IFU numbers (*Identifiant Fiscal Unique*, issued by the DGID), and the new legal status and obligations attached (i.e., ceiling of turnover required to maintain the status of the *entreprenant*, the need to keep a cash book).
 - A guide containing information on the tax obligations and the services the *entreprenant* can benefit.

Preliminary discussions with GUFÉ indicated that the agency may need an increase of three officers within its staffing unit.

5.2. Package A - Services and training (Implementing entity: CGA)

A mix of six trainings and five business advisory and information services were identified and validated with individual entrepreneurs (through focus group), entrepreneurs associations, and micro-finance institutions. They include guidance through the formalization process that will be offered to provide support to entrepreneurs wishing to register to the RCCM.

The advisory services will be carried out on a one-on-one basis with the businesses at their work places. They will be:

- Assistance to the registration to GUFÉ
- Provision of one-to-one follow-up assistance on the business activity
- Help with the structuring of the business activity and financial intermediation
- Provision of support in bookkeeping and management
- Assistance with loan management
- Introduction of the *SOS gestion*: a hotline that the *entreprenant* can call to get a quick advice.

The trainings will be:

- Basic accounting (cash book, billing, pro-forma preparation, using and analyzing the financial statements)
- Basic of micro-enterprise management (working with budget, controlling cost, cash flow management, stock management)
- Initiation to legal and tax obligations
- Financial education and awareness (products and services offered by commercial credit and microfinance institutions—where and how to obtain credit, requirements of creating of a bank account-checking and saving)
- Basic of developing an effective business plan (preparation of bankable proposals, new business, expanding business)

- Initiation to activity structuring and growing strategy (small business development and strengthening, access to market, dealing/negotiation with suppliers, etc.).

The *Centre de Gestion Agréé* (CGA, or business consulting and accounting center) will deliver the trainings and services part of Package A. CGA is an agency based in Cotonou whose mission is to offer small and medium enterprises with business management and tax consulting services. CGA will offer trainings and services via a dedicated “Entrepreneur Unit,” using modules customized and developed through two IFC standard products, the Business Edge and the SME Toolkit.

The initial recruiting plan included the hiring of 14 officers who will be detached to CGA to offer the services and the training to a population of about 1,500 entrepreneurs.

5.3. Package A - Support with bank services (Implementation entities: CGA, Orabank and/or Bank of Africa)

In addition to registration simplification, provision of information on the *entrepreneur* status, and provision of training and services to entrepreneurs by CGA, Package A of incentives includes the support to open a bank account.

Bank account opening services will be provided by CGA. They are not mandatory to the participants of groups one and two: the *entrepreneur* may directly open a bank account if he or she wishes. The bank account will be directly linked to the *entrepreneur*'s activity and it will not be a personal account. CGA will provide support to help the *entrepreneur* manage separately his bank account from its personal finances.

The banks partners of the IE (Orabank and/or Bank of Africa, BoA) will design a specific account for the *entrepreneur*, with dedicated services and/or simplified access conditions, including:

- Debit card
- Bank account consultation with mobile phone
- Access to bank branches in foreign countries
- Cash transfers
- SMS-banking
- Internet Banking
- Mobile money

Table 1 below summarizes the respective dedicated services and simplified access conditions offered by both banks to the *entrepreneur*.

CGA would assist the *entrepreneur* in structuring the information needed to open a bank account and give the necessary training to the entrepreneur on what he has to do (putting regularly some money on the account, for example), how he can use the account, the services he has access to and how he can optimally use them for his activity etc. CGA would also do a regular follow up to make sure that the *entrepreneur* is “correctly using” the bank account (under the specified

conditions the bank may assign to the account and according to any use related to business efficiency).

Table 1. Bank Account Packages proposed by Orabank and Bank of Africa (BoA).

Orabank	BoA
Reduction of account opening fees / initial deposit (from FCFA 50,000 to FCFA 20,000)	No initial deposit / fee on account opening
Reduction account management fee (from FCFA 5,500 to FCFA 2,200)	Reduction by half (50%) of account management fees (from FCFA 6,600 to FCFA 3,300)
- Flagship products: <ul style="list-style-type: none"> ▪ Temporary overdraft authorization ▪ Stock financing loan ▪ Stock financing and cash strengthening loan 	Flagship products: <ul style="list-style-type: none"> ▪ “Pack My Business (PMB)” i.e. joint savings account, debit card, distance banking (SMS, Phone) ▪ “Pack Fonxionariat,” including savings plan and overdraft authorization
All other Orabank conventional products on file review and at ordinary conditions	All other BOA conventional products on file review, and at ordinary conditions
Provision of all branches to serve the <i>entreprenant</i> (possible designation of dedicated branches thereafter)	Provision of all branches to serve the <i>entreprenant</i> (possible designation of dedicated branches thereafter)
Contribution to the <i>entreprenant</i> targeted communication through the edition of Factsheets	Contribution to the <i>entreprenant</i> targeted communication through the edition of Factsheets

The IE team is exploring the possibility of a second phase during which selected businesses may receive assistance in obtaining commercial loans, and others may get targeted tax inspections. The details of the latter will be discussed once the new tax regime is implemented (see next chapter). Annex 4 describes the main characteristics of these two additional interventions.

5.4. Package B – Provision of tax payment information (Implementation entity: CGA)

The *entreprenant* will receive a leaflet and additional explanations to help with the understanding of how to file and pay taxes, and the penalties in case of missed payments. The leaflet will clearly present the tax obligations of the *entreprenant* and provide examples of how this contribution will be used (including to pay for the tax mediator services). This communication campaign will therefore aim at educating taxpayers and promoting tax morale among the micro and small entrepreneurs. It will be prepared with WBG support and delivered by the CGA.

At the same time, CGA will also support the *entreprenants* in preparing their tax declarations, and certify them. The CGA tax advisors, who helped each *entreprenant* prepare their tax declaration, will leave them a contact information in case they have any complaints about future tax payments and inspections.

5.5. Package B – Provision of fiscal mediation services (Implementing entity: CGA)

This intervention will link some of the tax revenues paid by firms to the services offered by the Tax Mediator (*Médiateur Fiscal*), who will assist firms in disputes with the tax authority and ensure transparency in dealings with tax inspectors. Ideally, these services will be perceived by the *entrepreneurs* as a “benefit” they receive by paying taxes. This message should be conveyed through the specific, targeted communication that the *entrepreneur* will receive.

The Tax Mediator will be assigned to those entrepreneurs who formalize under the *entrepreneur* regime and will be hosted within the CGA. The mediator will take action when an *entrepreneur* asks for help in the interacting with the tax administration. Ideally, after the initial request, the mediator would become responsible, on behalf of the entrepreneur, of getting an answer from the administration for any issue highlighted. However, DGID has not agreed yet to this set up.

The entrepreneur will receive a leaflet describing how and when he can contact the Tax Mediator, what information he has to prepare, the phone number he can use to reach out, the address, and the time slots where he can see the mediator. This information will also be communicated orally at the time of registration at the GUFE.

After his interaction with the Tax Mediator, the entrepreneur receives a “payment form”, with a special color, that he will present to any administration agent who asks for any payment. When an agent visits him, the agent has to fill the document and give it to the entrepreneur (this form will be used when interacting with the Tax Mediator).

The Tax Code has defined a Tax Commission (dedicated to answer problems between firms and tax administration), and CGA is a member of this tax commission, as well as representative of the Tax Authorities. Thus the CGA can be empowered by the Tax Code to defend entrepreneurs affiliated to CGA.

The Tax Advisor-Mediator, hosted in CGA, will provide a mix of tax preparation support, certification, and protection in case the tax inspectors abuse their power.

6. Support with the new tax regime (Implementing entity: DGID)

A tax reform for micro and small enterprises is currently being discussed within the DGID, which should give readability and predictability to the tax system for micro and small enterprises.

A CIC team, in coordination with PREM and the IMF, will provide support to the Government with the new tax regime in the form of technical assistance to the *Direction Générale des Impôts et des Domaines* (DGID, the tax authority in Benin).¹⁷ The new tax regime will be applicable to all taxpayers in the country (under the designated threshold of FCFA 40 million of turnover).

Some of the principles currently being discussed include:

¹⁷ DGID is under the *Ministère de l'Economie et des Finances*.

- Synthetic tax
- Turnover based system
- Upper threshold aligned with VAT threshold (currently it stands at FCFA 40 million in annual turnover, or USD 82,000)
- Lower threshold being considered under which smallest businesses (with subsistence activities) may not be subject to any type of taxation
- Considering a single rate, or a limited number of rates, depending on sector/activities
- Annual payment
- 50% reduction of tax obligations during the first year of operation
- Introduce a tax penalty for informal firms who have failed to register (both tax and registry of commerce). Currently, the tax code (Art. 1020) calls for a penalty (FCFA 100,000, or USD 204) for informal firms found by the Tax Authorities. In practice, this penalty is not applied because it is too high (as a consequence, it leads to unwanted negotiations between the tax agent and the entrepreneur). The new tax penalty could be based on the tax amount due, for example
- Systematically condition the tax rebate to the provision of simple financial statements: Even if the new tax law requires small and micro firms to provide, we may still have non-compliers, thus tax reduction could be eliminated for those who do not comply
- Suppress the obligation to use CGA services to be eligible for the tax reduction.

The new tax regime will also include targeted tax inspections, i.e. systematic visits by tax inspectors, with summons to register, file tax form and pay in a short delay, for lack of which the *entrepreneur* will pay a fine. Information/vulgarization material will be distributed during inspections.

Currently, DGID inspectors visits every MSME's premise, assesses their tax due, and intimates the taxpayer to pay the amount they calculated by a certain date. DGID would like instead to move to a *declaration recueillie* (collected declaration). Accordingly, DGID would visit every MSME premise, providing businesses with filing document and explanations on how to calculate, file and pay (as well as deadlines, etc.). Then further visits would be done only in cases where (a) payments have not been made on time, or (b) audit takes place to check if the declaration stands the test (i.e. that the declared turnover is credible).

The reform will also include a general, nation-wide communication campaign about the new MSME tax regime.

7. Design, sampling, data

We will conduct a randomized control trial at the level of informal businesses and stratify the assignment by firm characteristics (using data collected during the baseline survey). The packages of incentives will target the specific segments of the informal sector that are most likely to benefit from formalizing: most likely, the high-end segment of informal entrepreneurs.

The key outcomes of interest are (1) formalization rate; (2) tax payments; (3) access to credit; and (4) firm performance.

7.1 Power calculations

Assuming that at most 10 percent of the control group firms formalize during the study period (end of the second follow-up survey), the target sample size of 1,000 in each treatment arm gives us power of 91.3 percent to detect a 5 percentage point increase in the formalization rate. Our target is in fact a 25 percentage point increase in formalization, in order in part to get sufficient take-up of formality to examine impacts of *being* formal on other firm outcomes.

It will also yield the same power to detect a 5 percentage point increase in the proportion of firms paying taxes or receiving a bank loan. To examine power for continuous outcomes like number of tax payments, amount of tax paid, and firm profitability, we require further data. Since the baseline data has not yet been collected to provide information on the actual levels and heterogeneity in these outcomes, we base the current power calculations on experience in other countries.

The above power calculations assume a 100% take up rate, but this is unrealistic given the context. If we expect to reach 75% of informal entrepreneurs with our intervention (the “take up rate”), then we would need a sample of 1,778 in order to detect a 5 percentage points increase in formalization rates $[1/(0.75)^2 * 1000]$. Thus each targeted sample size is approximately 1,800 informal businesses allocated to each of the three groups (two treatments and one control), giving 5,400 firms in total.

If we assume that the coefficient of variation for firm profits is 1, so that the standard deviation is equal to the mean, and that the autocorrelation is 0.5, then:

- The treatment leads to a 25 percentage point increase in the formalization rate, with a baseline and two rounds of follow-up data, using ANCOVA, and we have 81.2 percent power to detect a 36 percent increase in firm profits from formalizing. We will attempt to make the baseline sample as homogeneous as possible to reduce the coefficient of variation and reduce this minimal detectable effect size, as well as maximize the formalization rate.
- The power will be much greater for detecting increases in the amount paid as taxes, given that the control mean will be very low (hardly any control firms are expected to formalize and start paying taxes), so that we expect large relative increases in tax payments on this low base.

7.2 Sampling framework

From the previous power calculations, we will need a sample of 5,400 firms: 1,800 firms in each of the three groups.

The evaluation team has considered first the use of different available databases of entrepreneurs for the sampling framework:

- Database from the *Centre des Impôts des Petites Entreprises*, CIPE (the decentralized tax authority agencies);
- Database from the *Projet d'Appui au Développement des Microentreprises*, PADME (a microfinance institution);

- Database from *Institut National de Statistique et de l'Analyse Economique*, INSAE (the national statistics office);

Unfortunately, that these databases were either too limited (focusing on very specific entrepreneurs) or too old (the national firm census by INSAE was done in 2008). We have therefore decided to implement our own **pre-baseline survey**.

This survey has several advantages, chiefly that the team will not rely on data collected by other institutions, and that it will know exactly how the sample was constructed. In addition, this survey will provide us very useful information on all the firms in Cotonou, and thus on the external validity of the study.

More importantly, the pre-baseline survey will allow us to precisely define the eligibility criteria for the program. Indeed, in order to maximize take up of the program, we want to focus on high end informal firms. For this reason, the survey will focus on firms with a fixed location which are more likely to benefit the program. Following up with the firms will also be easier if we exclude street vendors from the sample.

In the pre-baseline survey, we will include questions on whether the firm is formal, the entrepreneur's level of education, age of the firm, number of employees, and whether the firm has some form of accounting.¹⁸ We will precisely define the program eligible population using this data and knowing that we need in total 5,400 firms.

For the pre-baseline survey organization, we plan to use two different methods: one for Danktopa market and the other for the rest of Cotonou. In fact, according to the 2008 census, more than 15% of informal firms in Cotonou are located in Danktopa market. We therefore need a special sampling procedure for this area.

- *Sampling framework for Danktopa market:* we will use a precise map of the market made by SOGEMA (*Société de Gestion des Marchés Autonomes*), the public company managing markets in Benin. This map of the market will allow us to divide geographically the market in small areas. We will then randomly select areas in the markets where we will survey all firms (with fixed location).
- *Sampling framework for other neighborhoods of Cotonou:* we will first use the INSEA 2008 census database to get information on firm characteristics at the neighborhood level. Using this information, we will do a geographical stratification of Cotonou in which to conduct the sampling.

7.3 Data collection

The team will conduct a sampling of the pre-baseline survey. Based on that, it will then conduct a comprehensive baseline survey of the 5,400 firms, followed by two follow-up surveys in 2015 and 2016.

¹⁸ The team will pay particular attention on how to define informality to make sure entrepreneurs understand properly what informality means.

Data will be collected on program implementation to better understand the quality of the programs. This also includes data on program cost. There may also be the need to conduct a qualitative survey to understand success and/or failure in the various treatment groups.

8. Threats to validity

This section describes the different threats to the validity of the impact evaluation and the mechanisms that the evaluation team will use to limit these threats.

8.1 Threats to internal validity

Unbiased estimation of program impacts requires control and treatment groups be comparable ex ante and randomization ensures this comparability in expectation. We will also stratify the sample before randomization using baseline data in order to support this comparability in practice on important observable firm characteristics. This will ensure that the treatment and control groups will be similar on business owner characteristics such as gender, education, age, etc., and on general firms characteristics such as location, age of the firm, size of firm, sector of activity, accounting methods, turnover, number of employees, etc.. In addition, the stratification will improve the statistical power of the study as treated firms are drawn out of strata with comparable observables. Baseline data will also allow us to verify the randomization was done successfully by performing balance checks on key outcome variables.

Attrition is one of the biggest challenges to impact evaluation. To keep it to a minimum, we will use the following methods:

- *Tracking of the study population:* the evaluation team will collect a maximum of information on firm owners to be sure that we can find them in the future. Since the sample may only include firms that operate in a fixed location, this problem may likely be limited.
- *Minimize response refusal rates:* we will consider offering gifts to respondents to encourage response. The initial sampling survey will provide information on the most efficient types of incentives to put in place.
- *Monitoring differential attrition:* since by definition the firms in the control group will not receive any treatment, they may have lower incentives to answer the follow-up surveys. To monitor this problem, we will carefully follow the attrition rate in each group during each survey. If there is significant differential attrition during one particular survey, additional means will be dedicated to firm tracking or to incentivize firms to answer the survey.

Another potential threat to internal validity is if the randomized assignment is not respected by the implementing partners. Indeed, as described in previous sections, there will be several different actors implementing the program, and moreover some institutions (CGA, GUFÉ) will be responsible for the implementation of both packages, A and B. To limit the risk of confusion between treatments, we will ensure that different teams (with different employees) actually implement the two packages and all means will be put forth to ensure a high compliance rate.

Finally, externalities (positive or negative) could also bias the results of the evaluation. Indeed, the intervention will be localized in Cotonou, and since the randomization will be done at the firm level, there could be externalities between groups. For example, if the treatment is particularly effective it may also increase formalization in the control group if formalization becomes the social norm. Firms in the control group may also start to see the benefits of formalization by observing the other firms in the treatment groups. In order to mitigate this problem, we will try to limit the proportions of firms included in the sample in each area concerned by the study. If these proportions are low enough, the externalities should be limited.

Information on externalities will be collected during the endline survey, and we will also consider implementation of qualitative interviews if we suspect the presence of externalities.

8.2 Low take-up in treatment group

As highlighted above, entrepreneurs may refuse treatment because they see little potential benefit. In order to ensure high compliance within the treatment group, we will carefully define the eligible population for the program through our own initial sampling survey and data from the 2008 census. We will use criteria such as the entrepreneur's level of education, age of the firm, number of employees, and whether the firm is doing some form of accounting to define eligible firms most likely to accept the program if offered.

Some components of the intervention such as trainings or assistance with opening a bank account are not mandatory. We could therefore have low take-up on each of the components as well. It will be essential to collect sufficient information on take-up (and reasons for non-compliance) for each program component in order to interpret the results of the evaluation. Qualitative interviews in addition to other follow up surveys will be also considered.

8.3 Threats to external validity

If firms selected in the study population are too specific (high-end firms), there is a risk of low external validity for a program aimed at all firms. There is indeed a trade-off between the need for high external validity for the study and the fact that we want to select firms with a high probability of take-up in the sample. This problem is however mitigated by the fact that the study sample is large (5,400 firms). Our initial sampling survey will also ensure external validity by defining a sample representative of all of Cotonou on which to randomize.

Another concern for the external validity of the study is whether some components of the program can be easily scaled up or not. In particular, the modified bank accounts may not be sustainable for the banks. It is difficult to answer to this question now, but we will collect information on implementing costs to be able to provide insight on this important question.

9. Timeline and deliverables

Milestones	Deliverables	Completion Date
Concept note	Note	January 31, 2013
Methodology note	Note	September 2013
Finalize implementation plan	Table	November 30, 2013
Finalize data collection plan	Table	November 30, 2013
Listing exercise	TORs Questionnaire	December 2013
Baseline data collection	TORs Questionnaire	January 2014
Start implementation		January 2014
First follow-up data collection	TORs Questionnaire	FY15
Second follow-up data collection	TORs Questionnaire	FY16
Final analysis	Technical note Policy note Data file Do files	FY16
Dissemination of findings	Presentation	FY17

10. Evaluation team and peer review process

Impact Evaluation team members: Louis Akakpo (IFC - Cotonou), Theodore Anthonioz (IFC-Dakar), Zoubir Benhamouche (CICBR), Najy Benhassine (CICBR), Julien Bornon (UNCTAD), Laurent Corthay (CICIT), Magueye Dia (World Bank - Togo), Benedicta Houetchenou (Government of Benin), David McKenzie (DECFP), Ferdinand Ngobounan (IFC), Victor Pouliquen (CICBR), Massimiliano Santini (CICBR), Kjartan Sorensen (UNCTAD), Hamidou Songo (IFC - Togo), Alain Traore (IFC - Dakar).

Counterparts in the Government of Benin: Antonin Dossou (*Ministre chargé de l'évaluation des politiques publiques et des programmes de dénationalization*), Abdoulaye Gounou (*Conseiller Technique à la Promotion du Secteur Privé*).

Peer reviewers: Leonardo Iacovone, Francisco Campos (?), Markus Goldstein (?), Suresh de Mel (?), Christopher Woodruff (?).

Annex 1: The informal sector in Benin

The most recent data on the informal sector come from a survey by INSAE (the National Statistics Office) and a survey on 4,859 firms conducted in 2008 by ECOPA¹⁹. We present here some stylized facts:

Informal sector size: The informal sector accounts for 2/3 of Benin GDP. Agriculture is almost entirely composed of informal firms. Informal sector accounts for 90% of total employment (Source: INSAE).

Firms' size: 98% of the firms are owned by individual entrepreneurs. Half of the firms have a share capital lower than USD 1,000, and it doesn't exceed USD 2,500 for almost all the firms (Source: ECOPA).

Financing: Two thirds of the entrepreneurs use their own funds to build the capital of their firm. This proportion is higher when considering investment financing (Source: ECOPA).

Turnover: Weekly turnover varies from USD 20 to a few thousands of dollars, depending on the sector where the entrepreneur operates (Source: ECOPA).

Entrepreneurs' level of education: Two thirds of the entrepreneurs have less than primary school education, and only 2% have tertiary education (Source: ECOPA).

Entrepreneurship type: Self-employment represents 72% of total firms in the informal sector (Source: *Commission Economique et des Finances*, Benin²⁰).

Contribution to taxes: In 2010, the tax contribution of the informal sector was estimated to be 0.86% of total taxes (Source: *Commission Economique et des Finances*, Benin).

Organization: There are hundreds of professional associations in Benin: 45% of entrepreneurs are members of these associations (Source: INSAE).

Business registration: The share of firms operating in the informal sector is estimated to be as high as 95.7% (Source: INSAE).

¹⁹ "Plaidoyer pour une structuration du secteur informel au Bénin," ECOPA report, November 2008.

²⁰ http://cesbenin.org/public/images/ressource/cesbenin-11092012141807-RAPPORT_CES_BENIN_SECTEUR_INFORMEL.pdf

Annex 2: Results of the Danktopa market survey

In November 2012, five 5 members went to the Dantokpa market and talked to 26 informal businesses. Here is a brief summary of the results of the survey.

Category of firms	Observations
Paying taxes and localized	Some businesses are localized in markets and others operate in shops in the street. Entrepreneurs operating in the markets pay a <i>Patent</i> ²¹ every year, and the tax administration collects this tax directly in the market place. These businesses already incur in some of the costs associated to formalization; they may be very sensitive to benefits.
Pays taxes and not localized	A fraction of entrepreneurs operate in the street, without any fixed localization.
Not paying taxes and not localized ²²	Some firms do not pay taxes at all or only sporadically depending on the controls of the Tax department. These firms are “the most informal” firms. Understanding their characteristics will be key. Small businesses in the street may not be qualified as “entrepreneurs”, they are in the “subsistence economy” and they may prefer getting a job.
Having access to credit (Tontine, MFI, Bank)	Even if not formalized, entrepreneurs may have access to credit. For example, Sogema - the public company managing “autonomous markets,” like the Dantokpa market - has signed an agreement with a MFI (ASMAB) to provide guaranties to the entrepreneurs who rent a place in the market. ²³ Part of the firms having access to credit may be less sensitive to formalization. On the other hand, some firms who benefit from access to credit may be more eager to formalize as they have reached a critical size where joining the formal economy becomes more pressing or beneficial.
Member of a professional association	Some firms are members of different associations of professionals (like craftsmen, farmers etc.). This may help getting access to credit (through group guaranty). These firms may be more sensitive to collective benefits. The spread of formalization “norms” may be also easier.

²¹ The patent is a tax paid annually. Officially, the tax is calculated by the tax office on the basis of the rental value of the shop.

²² We have to be sure that all localized firms pay taxes; otherwise we could add a category.

²³ When an entrepreneur defaults, he may be fired from the market, and SOGEMA gives ASMAB residual right on the place of the entrepreneur: ASMAB can sell an entry right to any new entrant.

Annex 3: Summary of tax regimes that apply to micro-entrepreneurs in Benin

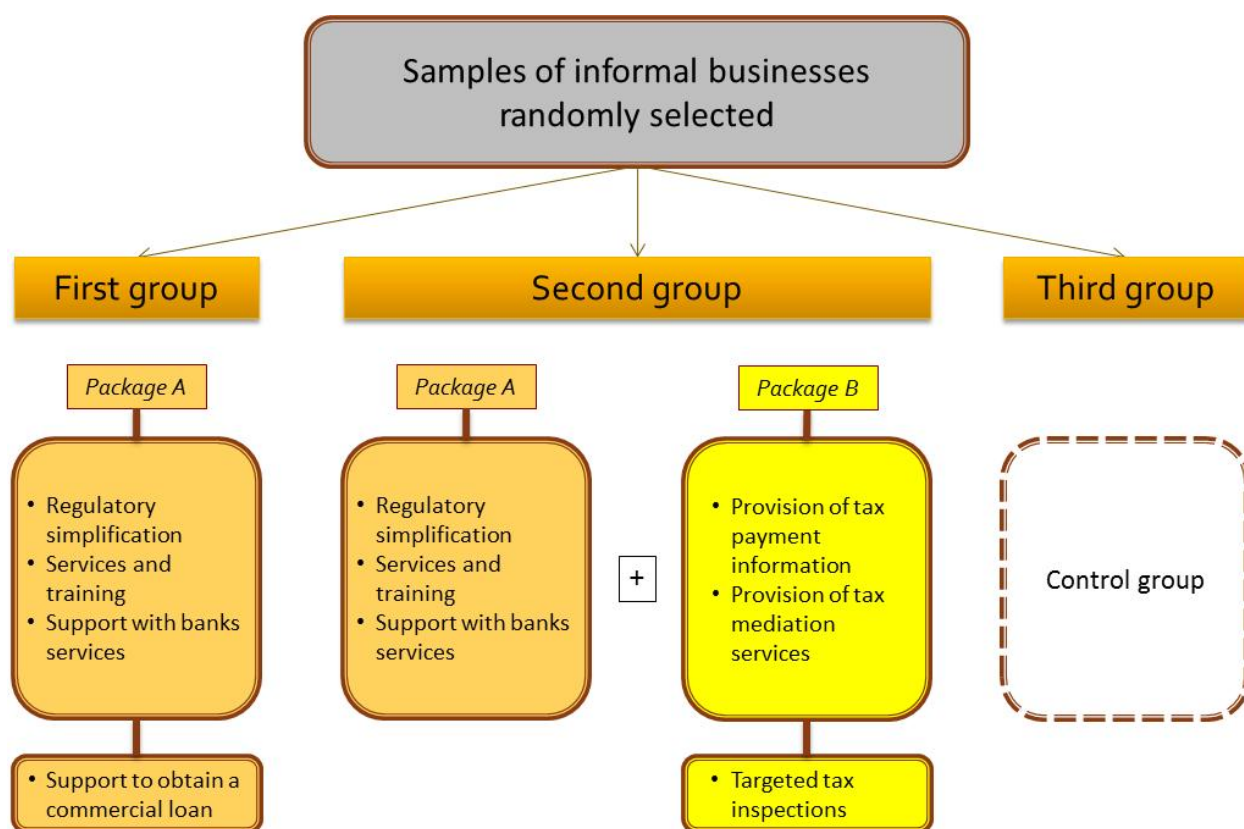
Type of <i>entreprenant</i> (entrepreneur with annual revenue below ~\$60,000)	Tax regime adopted in practice	Tax to pay	Calculation of Tax to pay
Entrepreneur exercising activity in <u>urban areas</u> , <u>inside</u> an organized market managed by SOGEMA (Ex. Dantokpa)	<i>Patente foraine</i> , <i>Forfait des</i> <i>revendeurs de</i> <i>tissus et divers</i>	<i>Patente</i> <i>foraine</i> , <i>Forfait des</i> <i>revendeurs de</i> <i>tissus et divers</i>	Patente foraine = based on published guidelines
Entrepreneur exercising activity in <u>urban areas with a</u> <u>land tenure</u> (<i>régime foncier</i> <i>urbain</i>), <u>outside</u> organized market	Flat tax regime - TPU	TPU	TPU = store annual rent * 12%
Entrepreneur exercising activity in <u>urban areas</u> <u>without a land tenure</u> , or in <u>non-urban areas</u>	Flat tax regime - classic	BIC + <i>patente</i>	BCI = 25% * gross profit <i>Patente</i> = 17% * store annual rent (in Cotonou)

Notes:

- All *entreprenants* have the option of staying in the Flat tax regime (*regime du forfait, classic ou TPU*) or opting for the Simplified tax regime (*regime reel simplifié*)
- TPU = *Tax professionnel unique*
- BIC = *Benefice industriel et commercial*
- The entrepreneur is exonerated from paying taxes in the year of registration
- The entrepreneurs affiliated with CGA (*Centre des Gestion Agree*) benefit from a reduction of taxes of 40% for 4 years
- The effective amount of the *Patente foraine* is decided by the CIPE (*Centre des Impôts des Petites Entreprises*) executive based on information collected by agents
- The calculation of both TPU and *Patente foraine* are not clear
- In case taxes are being paid late, there is a 10% penalty after the delay, but it is not clear whether or not this is applied in practice
- Also, the law mentions a penalty of \$200 if the entrepreneur has not declared its existence to the tax agency within 20 days of its existence, but it is not clear whether or not this law is applied in practice
- The calculation of the monthly rent of the business is discretionary by the agents from CIPE

Annex 4: Additional interventions

During a second phase of the impact evaluations, some businesses from *group one* may receive assistance in obtaining commercial loans, while other businesses from *group two* may get targeted tax inspections.



A4.1. Support with access to credit (Implementing agencies: CGA, Orabank, Bank of Africa)

Support to access to credit will not be a guarantee to obtain credit, but only a support to submit a credit application and to increase the business' chances of obtaining a loan from a commercial bank. These services could start 6 months to 1 year after the beginning of the intervention, and they could be proposed to those who have opened a bank account.

A subsample of entrepreneurs will be randomly selected from group one, and they will be offered support to get access to credit at the banks partners of the IE, including enough information to understand the credit process. Specifically, the support will consist in:

- Help businesses to identify growth/new business opportunities, express them in a business plan and derive the “optimal” credit amount that should be requested;
- Provide training to defend their project in front of a credit committee or loan officer;
- Provide post-credit services to accompany the entrepreneur to help him manage the credit: for example, use correctly the credit, make sure the entrepreneur correctly manages the cash flows to be able to reimburse the credit, help him find corrective solutions.

The partner bank should consider credit application for any business in group one.

Credit products will be discussed with the partner banks. Some options identified for the design of an attractive product include:

- Ease collateral pledge: for example, one bank is currently considering the possibility to suppress the obligation to register the collateral to a notary, or to consider simpler forms of collateral (to be detailed). This would ease collateral use and reduce the cost supported by the entrepreneur
- Introduction of specific products based on the type of activity to be financed (for example, cash flow financing, raw material purchasing, or equipment financing)
- Use entrepreneur’s savings as a credit base
- Interest rates lower than those offered by MFIs (around 18%). For example, one bank may propose an interest rate around 13%.

A4.2. Introduction of specific tax inspections (Implementing entity: DGID)

Currently the tax system gives incentives to staying informal, for at least 4 reasons:

- Whatever the formalization statute, entrepreneurs are subject to the same taxes
- During tax controls, tax inspectors do verify whether the businesses are registered with the *Registre du Commerce*.
- Tax system is vague, not predictable and leaves too much discretionary power to the tax administration
- When informal, a small/micro firm may easily evade taxes, enforcement is not effective and controls do not pose a credible threat.

For a random subsample of firms among the second group, tax agents may adopt a different communication and tax collection “strategy” that would include:

- Random sampling of a subsample of firms
- According to territory subdivision of agents, a random allocation of tax agents to a subgroup of firms in his territory will be done.
- X months after the introduction of the new tax regime and the ombudsman services, tax agents make inspections:
- Systematically ask questions on the formalization statute of the entrepreneur
- Give again information on the *entreprenant* statute, in particular on tax rules, tax break the first year, and tax reduction the second year upon providing very simple financial statement
- Detail the penalties amount the entrepreneur will pay if he doesn’t formalize

- Announce that a new control will be made one month later. If the entrepreneur has formalized, he will pay no tax. If not formalized: he will pay the penalty. He will clearly explain how the penalty is calculated and insist on the fact that the penalty is legal and is applied because the entrepreneur is informal and should have registered by law (this needs to cover both registration with tax office and with business registry: Under *entreprenant* status the entrepreneur will automatically get an IFU)
- At the end of the control, the tax agent will fill a form (to be prepared) containing all the relevant information collected during the control on the entrepreneur and his activity. A copy of this document will be given to entrepreneur. The tax agent will explain that the entrepreneur can use it when going to register at the GUFÉ.