

*Our latest note tests different ways to get firms to take-up a new formal status for entrepreneurs in Benin*

## ***Enhancing the Benefits of Formalization under a new status in Benin***

*Najy Benhassine, David McKenzie, Victor Pouliquen and Massimiliano Santini*

Existing evidence suggests that easing entry regulations and providing information on the formalization process has had only very limited impacts on the formalization of existing informal firms, especially with regards to tax registration.

One explanation is that although, in theory, formality has advantages in terms of access to business banking, government training programs, and tax certainty, in practice many firms which formalize fail to receive these benefits. As a result, the costs of formalization exceed the benefits, and so most firms stay informal.

### **The Entrepreneur Program**

Benin, along with 16 other OHADA countries in Africa, revised their commercial law to introduce a new status called *entreprenant*. This status is designed for micro and small businesses, and registering with this new status is easy, free of charge and takes only one business day. Formalizing means firms gain access to many of the key benefits of formal status, but also makes the firm registered for tax purposes.

The World Bank and IFC worked with the Government of Benin to pilot different approaches for how this status should be operationalized, and we use this opportunity to test via a randomized experiment whether offering supplementary services can enhance the benefits of formalizing for firms and bring more of them into the formal system.

### **Intervention Design**

We used a listing survey of businesses around Cotonou in early 2014 to

obtain a sample of 3,596 informal businesses. These were randomized into four groups:

- A control group of 1,197 firms
- Treatment group 1: received an in-person visit explaining the benefits of formalizing, and help with registering if needed.
- Treatment group 2: received the in-person visit, and also facilitated access to government training programs, and support to open a business bank account designed for the entrepreneur.
- Treatment group 3: in addition to the services provided to groups 1 and 2, was also offered support in dealing with the tax authorities including tax mediation services.

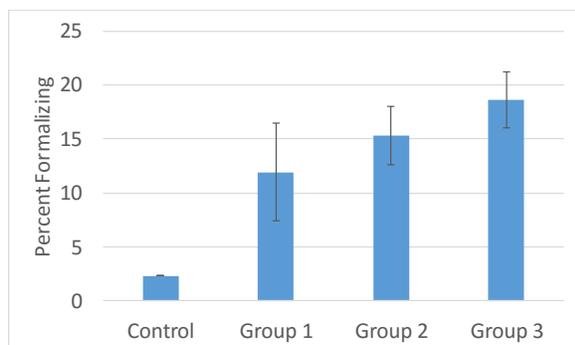
We later also implemented a subsequent treatment to test whether information alone improved take-up by giving half the control group leaflets explaining the new status.

Monthly administrative data on formalization allows us to trace out the formalization response, while follow-up surveys one and two years after baseline enable us to measure impacts on firm outcomes.

### **Results**

- Information alone has almost no effect on formalization. Adding the supplementary services did lead to large increases in take-up of the new status. The most comprehensive package of services (Group 3) boosted the formalization rate by 16.3 percentage points (Figure 1).

**Figure 1. Formalization rates**



Note: Error bars show 95% confidence intervals

- We use pre-specified tests of heterogeneity in take-up to learn how governments could best target these services. We find the impact on formalizing is higher for male business owners, those with more education, those operating outside the biggest market in Cotonou, and those that we classified ex-ante as being more similar to already formal businesses. Targeting on these characteristics could boost the formalization impact to 27 percentage points.
- Even with this targeting then, most informal firms choose to remain so.
- Formalizing leads to increased participation in business training, more formal accounting, lower tax harassment, and less taxes paid (due to a tax exemption in the year after formalizing).

- However, formal firms are not significantly more likely to obtain business bank accounts or loan financing, do not gain more customers, and have no significant gains in sales, profits, or standard of living.

### **Policy Implications**

The new *entreprenant* status does offer an improvement for those firms that want to become formal, making the process easier and cheaper. However, the existence of this status alone is not enough to induce many existing informal firms to formalize.

The supplementary services we tested do increase these formalization rates. However, while the benefits of formalizing are modest, the cost of the intervention is not. We calculate an average cost of US\$1,200-2,200 per firm formalized without targeting, and at least \$600 per firm formalized even if targeting were used. This is large relative to the average monthly profits of these firms of only \$79 and to the tax collection the government can expect to receive from such firms. As such, our analysis suggests that adding additional services or in-person visits to explain this new status is unlikely to pass a cost-benefit test.

Alternative strategies, including targeted enforcement may be needed to bring more of the larger informal firms into the formal system.

For further reading see: Benhassine et al. (2016) “Can Enhancing the Benefits of Formalization Induce Informal Firms to Become Formal? Experimental Evidence from Benin.” [World Bank Policy Research Working Paper no. 7900](#)

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