



Towards Inclusive Business Formalisation: A New Paradigm In Handling Business Informality?

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Day 2 Paper

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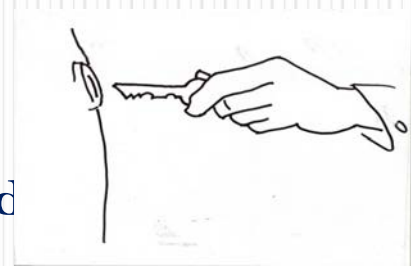
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TOWARDS INCLUSIVE BUSINESS FORMALISATION: A NEW PARADIGM IN HANDLING BUSINESS INFORMALITY?

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1. BACKGROUND, OBJECTIVES, APPROACH

- BEST-D is supporting a study on the informal sector with a view to formalisation
- Preliminary work (August September 2015)
- Extensive field study (September 2015 to January 2016)
- Stakeholder validation workshop – March, 2016
- Dissemination/ Validation ongoing here

WHY DOES THE INFORMAL SECTOR MATTER?

- It is a huge and important part of the economy:
 - 39% of GDP
 - 66-80% of urban employment
 - 40-50% are youth and at 48-54% are women
 - At least 90% of enterprises
- This huge/important part is unrecorded, legally unrecognized, unprotected – a big potential is wasted
- Formalisation measures, including simplification of regulations is apparently not having much impact (ILO, 2014; OEDC, 2014).

OBJECTIVE OF THE STUDY

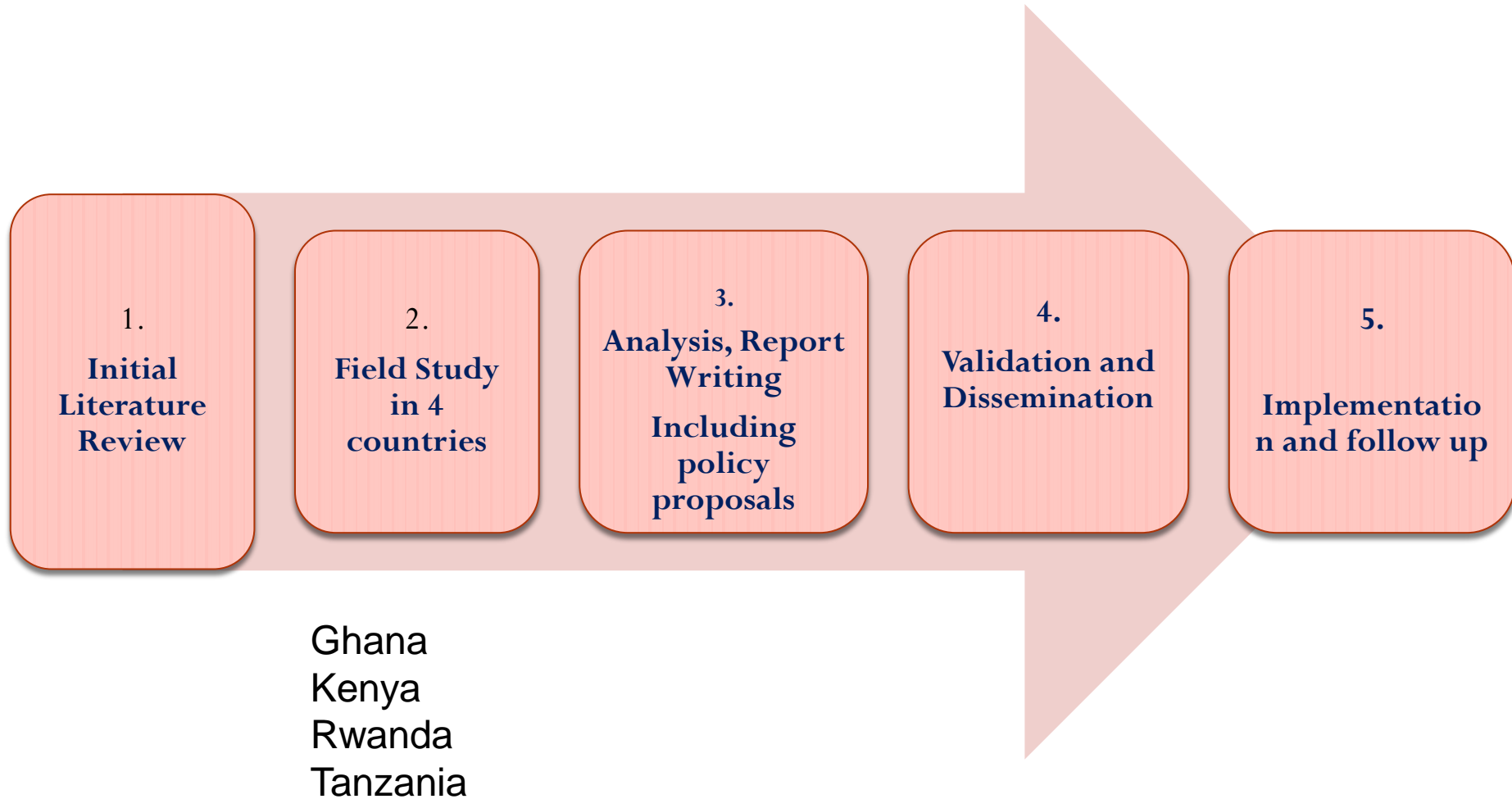
-to bring fresh insights into understanding the phenomenon of business informality and identify **simple and practical mechanisms** to transform informal businesses



SPECIFIC OBJECTIVES

- Critically examine the nature, causes and types of business informality
- Examine the experience, challenges, success stories and lessons from initiatives to manage and transform informality
- Seek fresh insights and bring fresh ideas into the business formalisation debate
- Make practical policy recommendations towards formalisation

APPROACH / STEPS



STUDY AREAS – IN-DEPTH INTERVIEWS WITH PUBLIC AND PRIVATE SECTOR ACTORS

Tanzania	Ghana	Kenya	Rwanda
Ilala Municipal Council Kinondoni Municipal Council Temeke Municipal Council Moshi Municipal Council Mwanza City Council	Accra Metropolitan Authority Ga West Assembly Ga East Assembly	Nairobi County	Kigali City Council

Participants from:

- LGAs, Government Ministries, Agencies,
- Business Associations,
- NGOs,
- Development Programs/Projects
- Informal operators – a survey of 179+FGDs and interviews
- Markets

2. LITARETURE REVIEW

- NATURE OF BUSINES INFORMALITY
- FORMALISATION APPROACHES AND EFFECTIVENESS

2.1. NATURE OF BUSINESS INFORMALITY

- **No commonly agreed definition**
 - 1) *not included in the law,*
 - 2) *operating outside the reach of the law;*
 - 3) *law is not applied or not enforced;*
 - 4) *law discourages compliance because it is inappropriate, burdensome, or imposes excessive costs (ILO, 2002)*

DIFFERENT DEFINITIONS, DIFFERENT BUT OVERLAPPING GROUPS OF ENTERPRISES

Entity/Study	Key criteria	Proportion of enterprises that were informal in 2010
National Bureau of Statistics	Incorporated businesses	Less than 1%
1991 National Informal Sector Survey and 1995 DSM Information Sector Survey and	Employ 5 or more people	11%
2010 MSME Study	Registered (even business name) by BRELA	About 4%
Common Usage	LGA Business Licence (always preceded by TIN registration)	About 10%

Theories of Business Informality (Why Informality exists)

- 1. Exclusion model**
- 2. Rational exit model**
- 3. Dual economy model**

Exclusion model

Businesses are rendered informal by legal requirements that are too complex, costly or alien

- Inappropriate, **implanted** regulations
 - Too complex and costly for the size of majority of enterprises/economy
 - Culturally alien
- Informality is desired by policy makers/influencers as a **competitiveness enhancing mechanisms for larger enterprises/the economy**
- Informality and related *vulnerability* is **preferred/sustained as a “vote bank” for politicians**

Rational Exit Model

- Business operators consciously decide to be informal after weighing the costs and benefits of formalisation.
- Benefits include
 - avoidance of rules, regulations and taxes
 - convenience and flexibility offered by operating informally

Dual Economy Model

- The informal sector is *a second (economy) a* unique segment, with low/poor skills, technology, productivity, ability to comply with the standards of the “modern” economy.
- The only option, and a safety net for the poor to secure their livelihoods

2.2 FORMALISATION APPROACHES

- 1) Building Awareness, Capacity and Productivity of Micro Enterprises
- 2) Regulatory Simplification (*most visible*)
- 3) Provision of Workspace
- 4) Enforcement of Compliance
- 5) Special Regulations for Micro Enterprises (*recent, emerging*)

Formalisation effectiveness

- Studies have focused on effectiveness of regulatory simplification
- Very little on other approaches

RECENT STUDIES ON EFFECTIVENESS OF REGULATORY SIMPLIFICATION

	Formalization initiative, research team, country	Results
1	One stop shop- combining municipal, state and federal business registration procedures) in urban areas. Bruhn (2011), Kaplan and Seira (2011), Mexico	<i>Business registration increased by about 5%, mainly due to wage earners opening new business</i>
2	One stop shop in less populous municipalities Bruhn and McKenzie (2013), Minas Gerais, Brazil	<i>Firms registering declined in the first 2 months, with no subsequent increase</i>
3	One-stop shop in 6 cities , Gardenas and Rozo (2009), Mexico	<i>Business registration increased by 5%</i>
4	Offer a subsidy for the cost of municipal license to informal firms. Alcazar et al (2010), Lima, Peru	<i>10-12% increase of informal firms obtained a municipal license</i>
5	Deliver brochures on process and benefits of formalization, waive registration fee and send a municipal inspector , Andrade et al (2013), Brazil	<i>Information and waiver of fees had no effect. Municipal inspection increased formalization by 22-27 % points</i>
6	Provide information and reimburse registration costs for informal firms, De Mel et al (2013), Sri Lanka	<i>No effect on formalization</i>
7	Deliver brochures with information to informal firms, Giorgi and Rahman (2013) , Bangladesh	<i>No effect on formalization rate</i>
8	One stop shop, Indonesia (Rosenberg, 2016)	<i>No effect on formalisation rate</i>

THE REALITY OF THE PRIVATE SECTOR (TANZANIA)

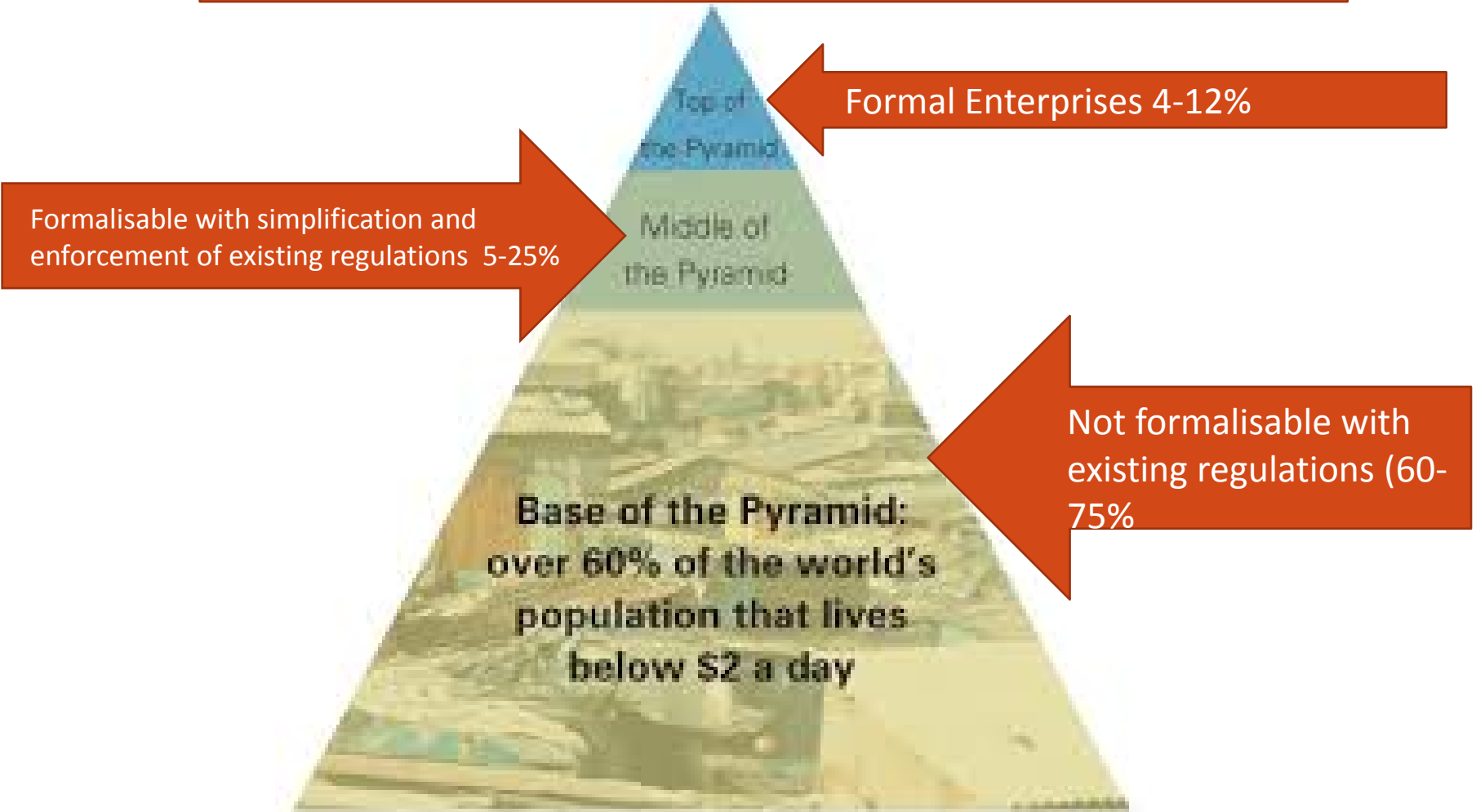
Aspect and Source	Indicator	%
Scale of Operation (URT, 2012)	Start-Up Capital less than Tshs 100,000 (50 US \$)	43-72
	Own account (one person enterprises)	66
Premises (URT 2012)	Does not operate from fixed premises	53.2

BUSINESS LICENSING

Basic formalisation is having a business license issued by District or Municipal Council Trade Officer. Basic requirements for a license:

1. Fixed business premises with either a title or lease contract
2. Tax Identification Number, preceded by tax clearance, and requirement to pay income tax in quarterly instalments
3. License fee is Tshs 50,000 at the minimum, excluding other costs
4. Have to pay tax in advance (though not a formal requirement)

Existing Regulations do not work for the base of the pyramid



SPECIAL POLICY AND REGULATORY FRAMEWORK FOR MICRO ENTERPRISES

- Kenya, Brazil, and South Africa have special policy and regulatory frameworks for micro enterprises:
- Recognized as different/distinct and requiring a differentiated approach in managing/regulating (dual economy model)
 - Micro and Small Enterprises Policies, Laws, Regulations and Regulators/Development Agencies in Kenya, Brazil
 - In Kenya, formal starts from being “traceable” within an association with at least 35 members. Level 2 is having recognized workspace. Level 3 is registration.
 - South Africa formally recognized the “second economy” from 2005, and has set up strategies for its handling/promotion which include tailored regulations and promotion of collective. Apparently not followed through with implementation
 - Rwanda (more in practice) has adopted promotion of cooperatives as the main approach to dealing with informality (not formalized in a detailed document)

3. KEY FINDINGS FROM THE FIELD

DIRECT FORMALISATION INITIATIVES IN THE COUNTRIES STUDIED

Approach	Tanzania	Rwanda	Kenya	Ghana
Simplification of business regulations	√	√	√	√
Voluntary pension schemes for individuals	√			√
Training on technical or business skills	√	√	√	√
Construction and management of markets and business complexes	√	√	√	√
Capacity building including provision of credit	√	√	√	√
Enforcement of regulations	√	√	√	√

Workspace and other Services Provided Directly by LGAs and MDAs

- Most LGAs provide workspace and are trying to expand.
 - Business Complexes build for micro enterprises (Ilala DSM, Nairobi, etc) not performed due to faulty design/location/resistance against rental fees, **rent seeking problem**
 - **UMANTIDA (Food Vendors) Case in Dar**
 - Investors (Mwanza, Accra) scared of politicisation and resistance by operators to pay economic fees
- LGAs and MDA also provide advisory, training, credit services, but with limited reach and effectiveness
 - Too many operators for them to serve
 - Not demand/need driven/tailored to characteristics and needs
 - Public sector business model is too expensive –to be worthwhile

EMERGING, INDIRECT FORMALISATION

Facilitating establishment and strengthening of of associations/cooperatives to achieve:

- Pooled registration, ID cards, databases of associations and cooperatives
- Self regulation on order, cleanliness, security, compliance with laws and regulations
- Communication, coordination by and with government
- Capacity building
- Marketing – aggregation, pricing
- Delivery of financial services

INDIRECT FORMALISATION INITIATIVES

Approach	Tanzania	Rwanda	Kenya	Ghana
Working with associations to support self regulation		√	√	√
Group registration/registration certificate by LGA	√			√
LGA performance contracts with associations		√		
Health insurance schemes through associations/registered groups	√			
Subsidies for construction of offices		√		
Free office space for associations				√
Issue of credit to association for on-lending to members				√
Government guarantee of association loans		√		
Training on technical or business skills through associations				√

ROLE OF COOPERATIVES AND BUSINESS ASSOCIATIONS IN INDIRECT FORMALISATION

- A few business associations are gradually taking an increasing role in facilitating indirect formalisation
- This includes associations that are exclusively for informal operators and those which are not
- Associations are also starting to built up premises for their members (as in Kigali with close government support)
- Other services – managing credit funds (Ghana)

FORMALISATION RELATED SERVICES OFFERED BY COOPS / ASSOCIATIONS TO MEMBERS

Functions	TZ	RW	KN	GN
Advocating for enabling environment	√	√	√	√
Capacity building of members	√	√	√	√
Market information	√	√	√	√
Negotiating for bulk purchase of inputs		√		√
Negotiating for input prices/output prices and access to markets	√	√		√
Jointly building premises with LGA	√			
Security				√
Self regulation (self policing on order and compliance to by-laws, LGA and national laws)		√		√
Access to pension schemes				√
Access to medical insurance schemes	√			
Credit to members	√	√		√
Traceability (Identity cards, databases)	√	√		√
Representation in employment issues				√

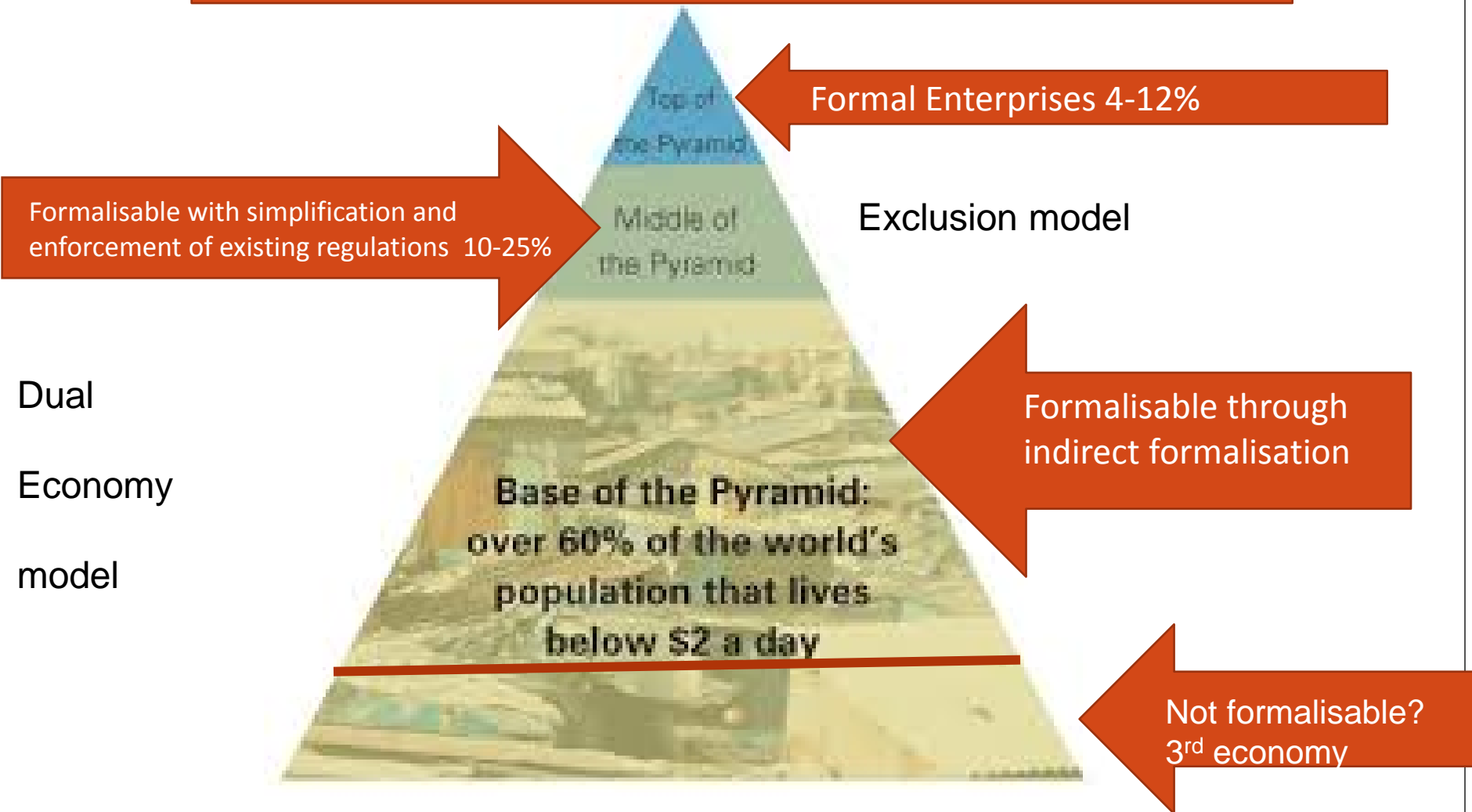
MUTUALLY RE-ENFORCING FORMALISATION PILLARS

- Strong associations are able to create a dynamic that make the four business formalisation pillars mutually re-enforcing:
 - A strong association is able to police members, influence policy makers, provide or influence availability of premises and markets, contribute to capacity building, which in turn attracts members and strengthens the association

INDIRECT FORMALISATION CREATES A MUTUALLY RE-INFORCING DYNAMIC AMONG FORMALISATION PILLARS



Existing Regulations do not work for the base of the pyramid



4. CONCLUSIONS AND IMPLICATIONS

CONCLUSIONS:

1. Simplification of existing regulations is not sufficiently inclusive.
Is necessary but far from sufficient for large scale formalisation
2. Due to failure of past formalisation attempts, a paradigm shift is taking place in terms of:
 - Designing specific policy and regulatory framework for micro enterprises.
 - Adoption of indirect formalisation - working through associations and cooperatives (pooled formalisation).

Theoretical implications

- Support for the dual economy model – a “*second economy*” segment that, though linked to the formal sector, is fundamentally distinct
- The exclusion model is relevant for all, while the dual economy model is relevant for a large part of informality
- New policy models emerging – special policies, regulators
- A potentially effective, **indirect** or **group formalisation** approach that relies, like the Grameen Bank model, on pushing the burden of regulation to micro entrepreneurs
- Receiving little academic interest, so far
- The We need to understand informality in specific contexts/segments

Recommendations – Policy Framework

- Consider dedicated policy and regulatory framework for micro enterprises and promotion and facilitation of indirect formalisation. To address:
 - Definition and levels of formalisation . The following levels are recommended:
 - (1) Being “traceable” through registration with a recognized association,
 - (2) A local government single business permit and operating from a recognized workspace,
 - (3) LGA license (including TIN Number) and fixed business premises with title or lease contract,
 - (4) Business name registration,
 - (5) Company incorporation

Recommendations - Policy framework

cont...

- Clarify on the nature of informality and policy thrust (what is sought through formalisation)
- Special business permits by LGAs indirectly formalized businesses with flexible schedule of payment by mobile phone
- Inclusive urban planning framework that provides for operations of micro enterprise
- Roles)and capacity building of key duty holders
- Model for building structures for micro enterprises to be in favour of ownership by the operators

Recommended immediate measures

- LGAs should have a focal person/office dealing with micro enterprises – including markets, association capacity building
- Pilot a business formalisation project as a partnership among willing partners
- Consider a designing a Business Formalisation Challenge /competition involving local governments and government agencies in undertaking pooled formalisation and self regulation in their respective sector/jurisdictions (successful in Rwanda)

Research needed

- Organisation of informal enterprises and potential for self regulation (different sectors)
- Action research – pilot self regulation as part of research
- Learn more about different segments of informal economy and how they are likely respond to different policy measures
- Effectiveness and lessons from special policy and regulatory frameworks for micro enterprises
- How the structure of a sector and the economy affect economic marginalisation and economic dualism

THANK YOU

QUESTIONS, ISSUES

Way Forward

- TPSF to facilitate dissemination
 - Parliamentary Committee on business
 - LGAs/DED's
 - Business Associations
 - Ministries responsible: Industry and Trade, Labour and Employment, RALG
 - TNBC
 - Ministry of Finance and Planning
- BEST Dialogue
 - Peer Reviewed- Publications (Journal articles, book)
 - Presentation to REPOA Annual Research Workshop on 6 or 7th April, 2016

- Other stakeholders (ESRF)
 - Social media
 - Tacnet? (online discussion)
 - Maendeleo Studio – to community radios