



## Making it Easier to Formalize Firms in Malawi and Access Financial Services

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***In contexts where formalization of firms and access to financial services is low, research shows that combining business registration with an information session at a bank including the offer of a business bank account leads to increased usage of financial services by entrepreneurs.***

### Introduction

Informal firms are smaller and less productive than formal ones, and their informal status is often associated with a number of costs, including less access to finance. Although 75 percent of the countries included in the Doing Business project have adopted at least one reform making it easier to register a business since 2004, informality remains very prevalent, especially in Sub-Saharan Africa.

One assumption related to the high rate of informal firms is that business owners do not want to register their firms, and another is that if only they registered, it would lead to great benefits for their businesses.

To find out what really works in incentivizing informal firms to register and to improve access and usage of financial services, the World Bank's Africa Region Gender Innovation Lab, Trade and Competitiveness Global Practice, and the Development Research Group, in partnership with Innovations for Poverty Action (IPA) launched an experiment to identify the impacts of different types of formalization assistance in Malawi.

We did this in the context of Malawi where only 7 percent of firms have registered with the government<sup>1</sup>. We aimed to see if entrepreneurs would take advantage of a costless business registration offer and if so, if this registration would have a positive impact on firm-level outcomes.

### Methodology

Our experiment targeted informal enterprises likely to be able to benefit most from registration in the country's major commercial cities of Lilongwe and Blantyre. We worked with a sample of over 3,000 informal firms, of which 40 percent were female-owned.

We randomly allocated participating firms into four groups. We offered three groups varying formalization interventions, while the remaining one was the control group. The first treatment group was offered assistance with business registration, the second was offered assistance with business registration and with separate tax registration. The third and final treatment group was offered assistance with business registration, as well as an information session with a bank that included an offer at the end to open a business bank account.

We then implemented the interventions in mid-2012 and gathered data on the take up of the different types of business formalization and their result on outcomes of interest including changes in access to

<sup>1</sup> Source: 2004-05 Integrated Household Survey, which shows 93 percent of firms are not registered with the Department of the Registrar's General (DRG).



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financial tools. The team conducted four rounds of follow up surveys, the first one from November 2012-March 2013 and the second from November 2013- March 2014, the third from November 2014-Mar 2015, and last one on May to September 2015 (3 years after the intervention).

### Research Findings

Neither the assumption that firm registration is low because entrepreneurs do not want to register their firms, nor that if only they registered, it would lead to great benefits, were true.

#### **1. We identified an effective and replicable design to offer informal firms support to formalize, at a much lower cost than the typical private sector development intervention.**

All three treatment groups had large impacts on business registration, with 75 percent of those offered assistance accepting and completing the business registration process. This benefits the government in providing a better picture of the firms that are active in their economy, and it allows enterprises to comply with the formal requirement to among others open a business bank account, apply for a loan in the name of the business, apply for government programs, and register with the chamber of commerce.

The all-in costs of conducting the business registration intervention was \$22 per registration offered and approximately \$27 per registration offer accepted. So this is an intervention that can be reasonably scaled up when compared with other interventions typically provided to firms. In sum, we found making registration costless will increase formalization of firms dramatically.

One caveat was that even with costless assistance, take-up rates for the tax registration were extremely low (only 4 percent), suggesting that it is the combination of a business formalization status that offers potential benefits (like bank access), low transaction costs and no implied future cost that is responsible for the high business registration take-up.

#### **2. Business registration on its own is not effective in improving access to financial services.**

Simplifying business registration on its own – the first group - was not effective in improving access to financial services. This intervention had limited impact on savings and an increase of 2-4 percent in the likelihood of having a business bank account in the short-term only (first and second follow-up), which was significantly smaller than the intervention that includes registration and a bank information session and did not last to third and fourth follow-up. There were no significant differences between male and female-owned enterprises.

#### **3. What works is combining business registration with an information session at a bank and an offer of a business bank account.**

When combining the business registration with an information session at a bank where offering a business bank account, the impacts on access to financial services were large. The combined intervention had large and positive impacts on the likelihood of having a bank account, having a business bank account, having insurance for the business, of not saving at home or through ROSCA/SACCO, on the amount the entrepreneur can borrow in two weeks, and the amount borrowed. The results were particularly encouraging in that the impact was high for women too, suggesting a way to increase women's access to financial services. Compared to the control group, women in this treatment group were much more likely to open a business bank account, to start keeping financial records and to have an insurance scheme, among a number of other benefits.



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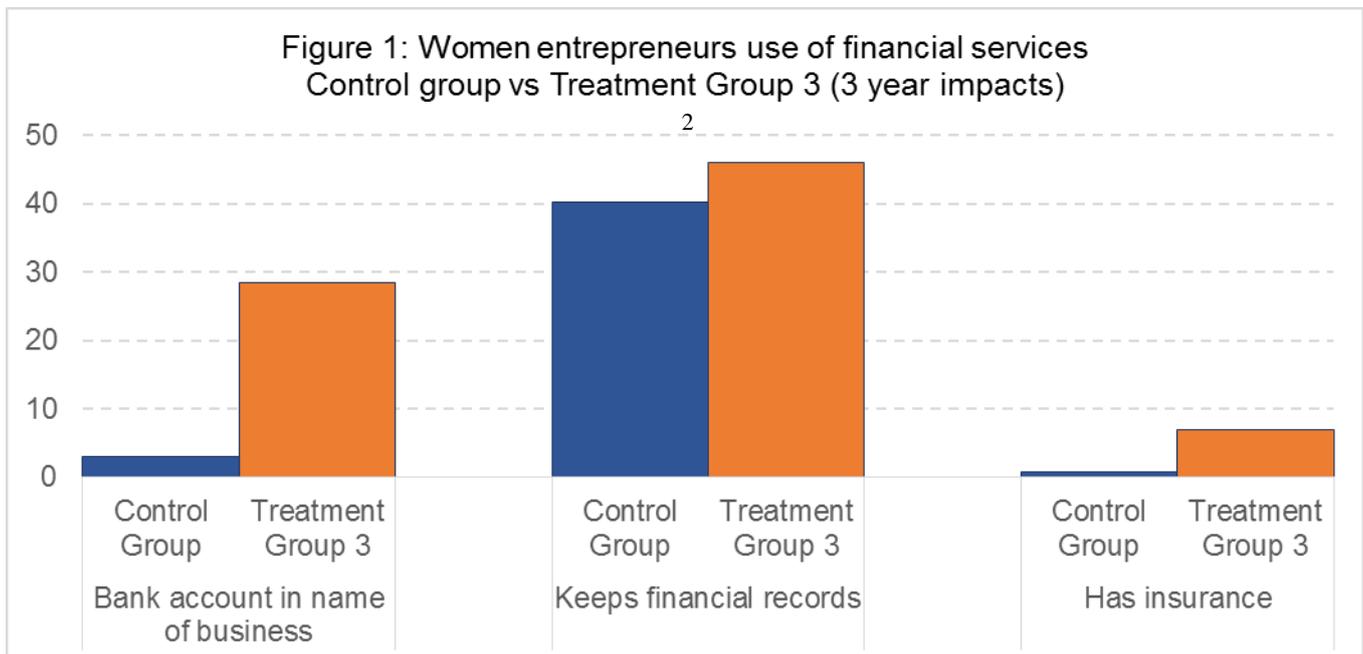


Figure 1 illustrates the effects compared to the control group for women in this treatment group 3 invited to an information session from a bank on top of assistance with business registration. The impacts shown in Figure 1 refer to those for the fourth and last follow-up survey (we found similar large differences in the other three follow-ups). While just 3 percent of the women in the control group had a bank account in the name of the business, this figure was 28 percent for the group offered information sessions at the bank. Female owned enterprises in this group were 6 percentage points more likely to have insurance and financial records than the women-owned firms in the control group.

### Moving Forward...

When finalizing this study, we will use all the data collected to analyze impacts of the different formalization interventions on other outcomes of interest, including business performance, access to markets and networks. We will also look at how informality exposes female entrepreneurs to more risks including confiscation of merchandise or requests for transactional sex from authorities threatening to shut down their businesses, and whether formalization could protect women from harassment.