



International
Labour
Organization



Enterprise
Formalization

CASE STUDY

► Formalization of micro and small enterprises and their employees

Experiences from Nepal

This document is part of a series of case studies by the Enterprises Department of the ILO. Each case study presents one or several approaches that contribute to enterprise formalization across the world. The case studies provide a snapshot on a particular initiative and may not be exhaustive.

Nepal is working towards graduating from Least Developed Country (LDC) status by 2026 and achieving the Sustainable Development Goals by 2030. As part of this effort, formalization of enterprises and workers in the informal sector has been made a key priority. The ILO has been supporting Nepal's formalization of the informal economy, supporting with the country's LDC graduation and SDG commitments. The ILO has supported the government through a series of activities aligned with the policy-making cycle including diagnostics, policy design and implementation, with key activities described below.



National policy frameworks

Diagnostics study on informality

In 2019, the ILO assisted the Government of Nepal in conducting a diagnostic study to assess the extent and drivers of informality in Nepal. The study was carried out in cooperation with the tripartite committee on formalization, led by the Ministry of Labour, Employment, and Social Security (MoLESS). This committee included representatives from various ministries (e.g. Ministry of Industry Commerce and Supplies, Ministry of Finance, National Planning Commission), the National Statistics Office and social partners.

This diagnosis study analysed factors, characteristics, causes and circumstances of informality in the national context. The study also identified barriers to formalization and proposed the development of tripartite-led national strategy and Action Plan outlining 18 major activities and 52 sub-activities. This was complemented by a range of reforms and measures to facilitate access to social protection, notably for workers in the informal economy (over 660,000 workers registering to the social security fund). Its [report on diagnostics of informality](#) was approved by the Central Labour Advisory Council, the highest national tripartite policy making body on labour and employment, in March 2022.

National Action Plan on Formalization

Based on the recommendations of the diagnostics study on informality validated by tripartite partners in April 2022, the tripartite committee oversaw the implementation of recommendations through Nepal's National Action Plan on Formalization. The committee then developed a first integrated action plan on formalization, which was put into implementation from August 2022 to February 2023, later extended until July 2025.

Nepal's National Action Plan on Formalization is an initiative aimed at addressing the challenges faced by both workers and economic units in transitioning from the informal to the formal economy, with a particular emphasis on women. The National Action Plan serves as a living document to identify pathways to formalization, with three main objectives and 14 intended outputs as follows:

- ▶ **Expand labour rights and social security:** Develop and approve contribution based social security scheme for self-employed, extend coverage of social security among MSMEs in informal and formal sectors, ensure representation and voice of workers and employers, workers have better understanding and access to labour and social security rights in all forms of employment improve implementation of labour and social security laws in the formal and informal sectors.
- ▶ **Facilitate enterprise formalization process:** Enterprise registration/renewal processes are simplified, integrated and made more effective, improved national business information management system, employers have better understanding and access to labour and social security rights in all forms of employment, enterprise registration compliance



mechanisms are strengthened and enforced, increase knowledge base about formalization benefits and procedures.

- ▶ **Improve business environment and reduce formalization costs:** Business friendly law and policy that results in decent work for out-comes for workers, improve productivity of enterprises and labour, improved and adapted tax and accounting systems that facilitate

formalization and inclusive growth, and enhance and operationalize incentives for formalization.

The plan outlined activities such as research on formalization, improved access to social security for informal workers, labour inspections, and awareness-raising on social security and formalization along with a timeline for implementation of these activities.

Mapping business formalization processes and incentives

As one of the activities planned under Nepal's National Action Plan on formalization, a mapping of the business formalization process and incentives was completed in 2024. The objectives were to document registration and renewal processes for economic units (including own-account workers and employers), identify challenges and incentives in transitioning to the formal sector, assess the costs and benefits of registration, and provide recommendations to support consensus-building among government and social partners on facilitating enterprise formalization. The main findings of the report include:

- ▶ Examining the current legislative and policy framework at the national, provincial, and municipal levels for registration and formalization of economic units in Nepal, the report identified gaps in the existing policies and legal requirements that are not conducive to promoting registration of enterprise such as multiple requirements of registration and renewal across agencies has led to confusion among economic units, multiple tax and charge payment requirements at different government authorities, conflicting provisions for micro-enterprise in terms of registration requirements, and inconsistent definition of different types of enterprise across federal and provincial levels.
- ▶ Reviewing the registration and renewal procedures, including expenses, roles, responsibilities, requirements, liabilities, and penalties for noncompliance, the report highlights key challenges encountered in the formalization process including the complex procedures (i.e. registration involves at least three government authorities, requiring businesses to comply with varying regulations), and high cost of registration and renewal (while

registration fees at one agency is manageable, payments across multiple agencies increase total accumulated costs and adding administrative burdens for economic units).

- ▶ Evaluating the incentives and perceived benefits of formalization, the report highlighted that while the government offers tax and registration rebates, awareness remains low thus limiting their impact. Most incentives target women, youth, Dalits, people with disabilities, and other disadvantaged groups to promote economic participation. Micro-enterprise incentives encourage grassroots entrepreneurship and formalization but vary across municipalities due to policy gaps. Local governments prioritize private sector growth and employment, mainly through training programs, but follow-up is minimal. Employment-related incentives are scarce, and awareness of the Social Security Fund (SSF) is limited to labour leaders, with many businesses avoiding SSF due to financial burdens and lack of understanding of its benefits.
 - ▶ The study found that penalties and fines vary across municipalities and provinces, promoting accountability and fair competition. However, these penalties disproportionately impact small and micro-enterprises that struggle with complex registration and financial penalties.
- Recommendations were made to make the process easier, more attractive, viable, and enforceable, aiming to reduce informality.
- ▶ For local governments, suggestions include streamlining the process to enable the creation of a one-stop shop, institutionalizing and supervising intermediary agencies

supporting registration procedures for economic units, conducting awareness raising campaigns, ensuring consistent registration and renewal costs across municipalities, and putting in place an alternative to the current requirement to submit a rental agreement for mobile economic units.

- ▶ For government agencies responsible for registration and renewal, it proposed to improve inter-agency coordination especially with the tax office, digitalizing formalization processes and enabling online registration, activating a helpdesk for entrepreneurs, building capacity of staff, simplifying the tax payment system, enforcing

punitive measures, putting in place robust monitoring and evaluation mechanisms, increasing staff for registration and inspection units, and providing incentives for regular taxpayers.

- ▶ For federal government, the report suggested defining types of enterprises consistently across provinces, providing an inclusive policy framework with effective formalization incentives, making SSF more accessible for micro and small enterprises, conducting labour compliance inspections, ensuring effectiveness of labour offices, and developing digital platforms and strengthening data management systems.

Assessment of social security contributory capacity of micro and small enterprises (MSEs)

Social security has been prioritized in the Government of Nepal's budget and programme. Following the launch of the formal sector contributory schemes in 2019, the government of Nepal expanded the contributory social security for informal sector and self-employed workers in August 2023. In support of this expansion, in 2024 the ILO initiated a rapid assessment which aimed to provide evidence on contributory capacity of formal and informal MSEs to the SSF. Specifically, the assessment:

- ▶ Assessed the financial capacity of MSEs to contribute to social security without compromising its operational sustainability since their revenue, profits and cash flow vary.
- ▶ Analysed the potential impact of existing contribution rates on the viability and sustainability of these enterprises, ensuring that contribution rates are set at levels that are feasible for the MSEs, to avoid overburdening contribution requirements that could

potentially lead to financial distress and business closures, which would have adverse effects on both the business owners and the overall economy.

- ▶ Assessed contributory capacity of workers in these MSEs, contribution rates relative to their wages, perception of minimum contribution periods and benefits received for both schemes, in relation to income and with respect to gender perspective.
- ▶ Identified barriers for participation in contributory social security scheme other than financial capacity from the perspective of enterprise owners and workers and various layers of vulnerability, including gender inequality and social exclusion.
- ▶ Provided evidence-based recommendations for incentivizing the participation of MSEs and their workers in contribution-based social security schemes.

Integrated National Strategy on Formalization

Another adjoining proposal by the tripartite committee was to develop an integrated National Strategy on Formalization, which was approved by the Central Labour Advisory Council (CLAC). This strategy, currently under development, aims to provide a longer-term

and integrated perspective on the formalization of economic units and workers in Nepal's informal economy. Its development process is also supposed to build consensus between wider stakeholders on the direction of formalization in Nepal.



Formalization support measures

In addition to the above-mentioned macro-level interventions, a few meso- and micro-level interventions are being implemented.

Sectoral diagnostics of informality in agriculture, construction and transport sectors

A complementary sectoral approach, guided by a sectoral diagnosis, has been deemed necessary to tackle sectoral and transversal drivers of informality. The tripartite committee implementing the National Actional Plan on Formalization identified agriculture, transportation, and construction as priority sectors where dedicated diagnostics of informality should be conducted. These sectors were selected based on criteria such as higher prevalence of informal

employment in these sectors compared to the national average, a concentration of more vulnerable forms of employment, specifically contributing family workers, own-account workers, and daily wage workers, and the prioritization of these sectors in national programmes and policies, as determined through a mapping by the tripartite committee. Sectoral diagnostics reports for these three sectors are currently underway.

Digitalizing processes for enterprises to complete their annual labour self-audits

The Labour Act, 2017 requires that all enterprises conduct an annual self-labour audit and submit the form to their nearest labour and employment office. For context, there are only 11 such officers for over 900,000 economic establishments in Nepal. The labour audit submission process has now been fully digitized with technical assistance from the ILO, and the system

has been integrated to that of the SSF. This means that now, any information from submissions is instantly verified across systems, and stored in a government central digital database, which allows for smoother enforcement. The process to connect information from the labour audit and SSF with the tax authority is now underway.

ILO's Formalize Your Business (FYB) training

In line with increasing focus on formalization, the ILO supports Nepal in rolling out a training module on enterprise and job formalization entitled "[Formalize Your Business](#)". The training aims to build the capacity of informal MSEs through Employers and Business Member Organisations (EBMOs), government agencies, and entrepreneurship ecosystem partners. The training tools were adapted to the context in Nepal. Training of trainers was conducted and trainings of entrepreneurs are underway. National social partners such as the Industrial Enterprise Development Institute (IEDI), provincial governments, municipalities, national vocational training academy, FNCCI, Federation of entrepreneurs have partnered to roll out the FYB trainings.

Key takeaways

- ▶ The interventions above demonstrate a comprehensive approach to formalization, encompassing full cycle from diagnostics to policy design and implementation.
- ▶ A tripartite committee, overseeing the diagnostics on informality, developed an action plan to implement its recommendations, serving as a key factor in the process.
- ▶ The interventions above lay preparatory groundwork for changes. While additional strategies are required in areas such as labour protection, labour audits, social security, tax simplification, financial access and business development services, etc., the interventions offer key entry points to support enterprises and their workers in transitioning towards formalization in Nepal.
- ▶ Formalization of MSEs is essential to provide decent work for their employees. However, cost requirements are often not well aligned with the capacities and realities of smaller enterprises. ILO's engagement with the Social Security Fund and the study to assess the contributory capacity of MSEs for social security entails a very promising avenue to leverage enterprise formalization for decent work through access to social security for business owners and workers.

ILO's support has contributed to strengthening institutional collaboration, particularly for data exchange among key ministries, and using technology to ease compliance for enterprises.



More case studies on enterprise formalization can be found [here](#)