Enterprise Formalization: Simplifying and facilitating business start-up and compliance

Thematic Brief 2/2021
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This document is part of a series of briefs on Enterprise Formalization that describe some of the measures that can be taken to support formalization, in line with ILO Recommendation 204 concerning the Transition from the Informal to the Formal Economy. It is recommended to carefully tailor an enterprise formalization strategy to the needs and characteristics of the entrepreneurs, based on an assessment of the situation in a particular country or region. Some informal opportunity entrepreneurs would be able to formalize their business if adequate policies, regulations and support measures are put in place. Others may engage in livelihood activities and need support to address decent work deficits as a first step towards possible formalization in the future. Enterprise formalization strategies may include measures to make it easier to register and comply with the law (e.g. through simplified laws and procedures), make formalization more attractive (by increasing incentives and removing disincentives to formalize), bring formalization within reach (by enhancing enterprise productivity) and make operating informally less attractive (notably through strengthened enforcement and compliance measures). Strategies may also include reforms to bring small economic units' within the scope of the law. The development, implementation, monitoring and evaluation of enterprise formalization strategies rely on a process of dialogue to identify, consider and address the constraints that affect the targeted informal enterprises and stand in the way of their formalization.

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1 In this context, the term economic units refers to: (a) units that employ hired labour; (b) units that are owned by individuals working on their own account, either alone or with the help of contributing family workers; and (c) cooperatives and social and solidarity economy units. This brief refers to economic units, including own account workers with no employees, as enterprises.
This brief discusses the formalities required to start up an enterprise, as well as the ongoing regulatory compliance formalities that apply to the enterprise over its lifetime. The focus of this brief is on how to reduce information gaps and eliminate inefficiencies in the implementation of relevant regulations that apply to small economic units (as opposed to reforms of the regulations themselves, which are addressed in Thematic Brief Enterprise Formalization: Tailored registration, tax and social security requirements for MSEs, No. 3/2021), with the objective of reducing the monetary and non-monetary cost to enterprises of complying with those regulations.

This brief proposes two major streams of intervention:

- **Cut red tape**: eliminate unnecessary documents, procedures and fees by improving the administration of business start-up and closing and ongoing compliance formalities by the relevant government bodies;
- **Enhance access to information and support for enterprises**.

Coupled with other measures such as productivity growth and incentives, both types of interventions are needed to encourage and enable informal enterprises to move into the formal economy.

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**Figure 1: Recommended enterprise formalization approach**

| 1 | Make it easier to register and comply (simplifying laws and procedures) |
| 2 | Make it more attractive to formalize (incentives) |
| 3 | Make it more feasible to formalize (productivity enhancement) |
| 4 | Make it less attractive to be informal (enforcement and compliance) |


**Figure 2: Simplification of business start-up formalities as a means of promoting greater formalization**

- **Procedural mapping (BPA)**
- **Simplification**
- **Intra-governamental coordination (One Stop Shops)**
- **Digitalization**

Transparency
Reducing the cost of enterprise formalization by cutting red tape

Compliance can be made less burdensome through the simplification of document requirements and the streamlining of compliance procedures. The World Bank’s Ease of Doing Business indicators (2020) show that in most regions, starting a formal enterprise still takes more than 15 days on average in the world’s developing regions, while the cost ranges from 3 per cent of income per capita in OECD high-income countries to 36 per cent in Sub-Saharan Africa. In some countries, starting a business can involve up to 20 procedures, take up to 230 days and cost up to 211 per cent of income per capita. Costly and time-consuming procedures usually indicate that regulations are being implemented in an inefficient manner; entrepreneurs have to present the same information about their business, through numerous different documents and to multiple government agencies. Lack of information usually aggravates this problem: on the one hand, entrepreneurs waste a considerable amount of time figuring out what the various requirements are before they can fulfil them; on the other hand, government departments and individual officers tend to be unaware of the overall complexity of the process, since they are themselves only involved in one of several steps. In most cases, simplification needs to start with a comprehensive mapping of the full set of procedures that the user (i.e. the entrepreneur) is expected to complete. Once this information has been collected, it is good practice to make the information available to decision makers and other interested parties from both the public and

Figure 3: Ease of Doing Business indicators - time (days) and cost (% of income per capita) of starting a business by region

Reducing the cost of enterprise formalization by cutting red tape

the private sectors, to serve as the basis for further discussion and analysis. This kind of clear and well-presented information on the step-by-step process for complying with administrative formalities (including documents, interactions, fees, waiting times and the institutions involved) can make it easier to identify bottlenecks and redundancies, and to prioritize reforms. This is therefore the first stage in a collective effort to optimize compliance formalities.

One of the most common inefficiencies in the administration of compliance formalities is the lack of intra-governmental coordination. For organizational purposes, public administrations are separated into different bodies (ministries, agencies, departments, regional and sub-regional units), each with its own mandate and area of jurisdiction, such as labour, social security, health, the environment, or regional / municipal government. When it comes to the regulation of formal enterprises, these mandates often overlap. A small guesthouse with a restaurant, located in a national park and comprising four or five staff, for example, would be expected to meet several obligations, including: company registration in the national business registry; the acquisition of a license from the municipal authorities; the registration of employees with the labour authorities and the organizations responsible for managing social security contributions (e.g. unemployment insurance, health insurance, pensions). The enterprise would then have to ensure compliance with food safety standards (e.g. HACCP), and environmental regulations. Over its lifetime, the enterprise would have to remain up to date with its accounting obligations, make regular payments of social security contributions and taxes, and may have to undergo inspections by labour, health or environmental authorities. Dealing with various government interlocutors can be disorienting and overwhelming for small enterprises run by entrepreneurs with a limited level of educational attainment. When starting up, different government bodies may make repeated requests for the same or similar information. Requirements can sometimes be interdependent, meaning that the entrepreneur is obliged to wait for an official response from one interlocutor before moving on to the next step of the process. Ongoing compliance formalities (e.g. financial reporting, inspections) can also be very time-consuming and even stressful, since a mistake might result in fines, temporary or permanent closure, confiscation or other penalties. For many enterprises, it may appear easier to simply remain informal.

Start-up formalities and ongoing compliance procedures can be streamlined through business facilitation measures and greater intra-governmental coordination. The most basic reforms are easily achievable through

Figure 4: One-Stop Shops: Simplifying business start-up formalities of a guesthouse through intra-governmental coordination
common-sense measures that become obvious once a procedural mapping process or Business Process Analysis (BPA) exercise has taken place, such as the elimination of obsolete or redundant document requirements. Other widespread and effective facilitation measures include: the elimination of minimum capital requirements for the establishment of a business, automatic licensing (with ex post verification of eligibility and compliance) and exemptions from some accounting requirements, such as the compulsory issuance of invoices. Improved intra-governmental coordination can also help to minimize the administrative burden for enterprises, by demanding that government bodies share information and transfer documents between themselves, rather than making multiple requests for the same information to the enterprise (see Box 1).

The creation of one-stop shops is an effective way of facilitating business registration by bringing together several registration procedures and relevant agencies. The World Bank states that “in the 83 economies with one-stop shops offering at least one service beyond business registration, businesses can start up more than twice as fast as in countries without such services”. In an ideal scenario, one-stop shops function as the sole interlocutor between enterprises and the State. They centralize as many administrative formalities as possible into one (physical or virtual) location, which then becomes the reference point for entrepreneurs who need to complete registration and compliance formalities. An interesting typology of different one-stop shop models has been developed by the World Bank and is summarized in Figure 5. ‘One door’ shops are the easiest to implement, as they do not require any change in the administrative responsibilities of different government bodies. Those government bodies are simply brought together into one location, where the entrepreneur can address them, one by one, in order to complete the relevant formalities. The ‘one door’ model does not automatically result in the simplification of formalities, but entrepreneurs nevertheless benefit from being able to solve their administrative problems in one location. The model can, moreover, give rise to spontaneous intra-governmental coordination and information-sharing, by mere virtue of making public officials work close together under ‘one roof’. The ‘one window’ and ‘one more stop’ models, by contrast, require the delegation of responsibilities, either to an existing government body (in the case of ‘one window’) or to a new body created for the specific purpose of administering enterprise-level regulations (the ‘one more stop’) (World Bank, 2019). These models are harder to implement, as government bodies may not want to surrender control over administrative processes or to allow other bodies to make incursions into their area of jurisdiction. Even when the relevant government bodies are willing to surrender control, a lot of work needs to be done to ensure that rules, regulations, procedures and IT systems are compatible with one another. That said, ‘one window’ and ‘one more stop’ systems promote even greater efficiency, as they allow enterprises to interact with only one official, who is responsible for accepting documents, receiving payments and completing formalities on behalf of government bodies other than their own.

Box 1: Anti-Red Tape Law in Costa Rica

In 2002, Costa Rica’s Anti-Red Tape Law was issued to protect citizens and enterprises from administrative inefficiency and corruption. Under this law, entrepreneurs cannot be asked to provide the same information twice to the State. The Law thus promotes inter-agency coordination: any public agency that requires information that is issued or held by another public agency cannot request it from the person, but must rather coordinate with the other public agency to obtain the information.

Reducing the cost of enterprise formalization by cutting red tape

In addition to simplification, technology can be used to transfer documents, share information and make payments electronically, promoting greater levels of e-formality. Analysis by the ILO (2018) has shown that there is a correlation between the degree to which government services have been digitalized (as measured by UNDESA’s e-government indices) and the reduction of informality rates across countries. This is because the digitalization of administrative formalities - including business start-up and ongoing compliance formalities - can significantly reduce the costs to enterprises of transitioning to, and remaining in, the formal economy. One-stop shops can be made virtual, eliminating the need for an entrepreneur to travel to a physical location in order to deliver paper-based documents in-person. Electronic systems can also unify the payment of service charges, taxes, social security contributions and other sums due to the government into one online payment, automatically calculating amounts payable and ensuring that the correct shares are redirected to the relevant public bodies. Greater use of electronic payment systems can save entrepreneurs from the need to carry large amounts of cash, which makes them liable to theft or extortion. It can also improve traceability and reduce corruption, as it is much harder to deliberately conceal or misrepresent an electronic transaction. Finally, electronic payment systems can save time: online portals for the payment of taxes and social security contributions allow entrepreneurs to quickly provide relevant inputs and verify calculations in ‘one click’. Furthermore, some government systems are directly linked to electronic point-of-sale (POS) systems and payment terminals, facilitating the collection of data on sales and the calculation of sales tax, VAT, or social security contributions and reimbursements. In addition to their speed and efficiency, these systems remove the element of human error from enterprise bookkeeping functions and generate savings on professional accounting services.

Source: World Bank, 2009

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4 These ‘online stops’ often build on the procedural mapping (or ‘Business Process Analysis’) that is carried out in an earlier stage of the reform process.

5 See here for more information: https://www.social-protection.org/gimi/Course.action?id=3

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**Figure 5: How many stops in a one-stop shop? A typology of one-stop shops**

<table>
<thead>
<tr>
<th>One Door</th>
<th>One Window</th>
<th>One More Shop</th>
<th>Online Stop</th>
</tr>
</thead>
<tbody>
<tr>
<td>“One door” or “one roof”</td>
<td>Enterprise interacts with only one official, who is authorized to accept documents for government bodies other than their own.</td>
<td>Establishes a new organization responsible for coordinating between different government bodies.</td>
<td>Business start-up formalities can be completed online.</td>
</tr>
<tr>
<td>Government bodies are bought together in one location.</td>
<td>Requires legislative change and delegation of responsibilities.</td>
<td>Does not require major restructuring of other administrative bodies.</td>
<td>Management of the online platform can follow either the “one door”, “one window” or “one more stop” logic.</td>
</tr>
<tr>
<td>Simple to implement (subject to availability of premises).</td>
<td></td>
<td>Increases the overall cost of administrative functions.</td>
<td></td>
</tr>
<tr>
<td>Does not require change in legislation or ministerial responsibilities.</td>
<td></td>
<td>Does not necessarily reduce timeframes.</td>
<td></td>
</tr>
</tbody>
</table>
Supporting enterprises to comply with formalities and to advocate for reform

Advocacy is needed to drive reforms within the framework of strengthened social dialogue mechanisms. Governments are more likely to undertake certain measures – including procedural mapping, simplification, intra-government coordination and digitalization – if their stakeholders express the need for such reforms and request government support in providing them. This advocacy role can be carried out by organizations who have a stake in the reform process, including workers’ organizations and employers’ organizations, with the support of informal sector representatives. Advocacy is best conducted under the auspices of social dialogue mechanisms, which bring together government and social partners to discuss and develop reforms based on consensus. Moreover, representatives of employers and workers are usually represented in the boards of social security institutions (ILO, 2019b).

For informal enterprises, raising the profile of this debate within the social dialogue process has clear upsides: lower entry costs can facilitate the formalization process, ending the risk of detection by law enforcement officials and allowing them to benefit from advantages of operating in the formal economy, such as access to social security, government support services, finance and formal markets. Both formal and informal enterprises are, moreover, best placed to confirm the accuracy of procedural mapping exercises, to identify the main bottlenecks in the regulatory framework, and to assess the effectiveness of one-stop shops and e-Government platforms.

For people who are employed by informal enterprises, the stakes are even higher: evidence suggests that simplification efforts and one-stop shops may facilitate the registration of new firms, but not necessarily the formalization of the workers they employ (Deelen, 2015). This could be due to the exclusion of workers from the design of simplified start-up and ongoing compliance formalities. It is important to organize workers in informal employment and increase their participation and voice in social dialogue mechanisms. This can ensure that the inclusion of employee registration within the framework of a one-stop shop or an online business registration platform is on the agenda, include access to social security and other workers’ rights as an integral part of an improved business environment and raise workers’ awareness of social security and other benefits (ILO, 2019b. Chapter 3).

The simplification of compliance formalities is unlikely to generate the desired impact if it does not go hand in hand with increased transparency, sensitization and support to small enterprises. Once business start-up and ongoing compliance formalities have been simplified (through business facilitation measures, the establishment of one-stop shops or the digitalization of procedures and payments), outreach activities are still needed to encourage a group of informal enterprises to be ‘pioneers’ of the new formalization process. Entrepreneurs in the informal sector face competing demands on their time and will not engage with new government initiatives unless the value of doing so is clear. As part of a formalization drive, therefore, it is important, to aim for behavioral changes and offer transparent information to targeted entrepreneurs through appropriate channels: television, radio, webinars, public events and, increasingly, social media. Communication campaigns should seek to educate the public on the benefits of formalization, including those that accrue to enterprises specifically and those that are more diffuse in nature, such as the ‘public goods’ that result from greater regulatory compliance. They should also provide information on the new, simplified compliance formalities, in a practical and user-friendly way. The formalization process is even more likely to be successful if entrepreneurs are offered some assistance or ‘hand-holding’ in the first instance, to become familiar with the formalities themselves but also with some of the benefits of formal status (e.g. opening a bank account, signing up for government support programmes, etc.). If a critical mass of enterprises is able to make the transition successfully, word-of-mouth can be relied upon to do the rest.

Despite the importance and usefulness of measures to simplify and facilitate business start-up and regulatory compliance formalities, it is important to keep in mind - as pointed out in Figure 1 - that these measures are not a panacea to address informality in micro and small enterprises. They are rather part of a broader
solution which also makes formalization more attractive, enhances compliance and brings formalization within reach - through productivity enhancement – for a larger segment of micro and small enterprises. Furthermore, a conducive business environment is needed to ensure that enterprises can effectively operate and thrive in the formal economy.

Box 2: Benin: One-stop shop

The 17 member countries of OHADA (Organisation for the Harmonisation of Business Law in Africa) adopted a revised General Commercial Law in December 2010, which entered into force in May 2011. This new legislation enacted the status of entreprenant, which is a simplified legal regime specifically designed for own-account workers with low turnover, with the aim of facilitating the transition of informal enterprises to formality. The OHADA law predominates over national law. This legal status facilitates registration (which is the topic of this thematic brief), and has the potential to incorporate various advantages (which is covered in Thematic Brief Enterprise Formalization: Tailored registration, tax and social security requirements for MSEs - No. 3/2021).

As a member of OHADA, the government of Benin has introduced the entreprenant status as part of a broader effort to simplify and reduce the costs of formalization.

The GUFE - Guichet Unique de Formalisation des Entreprises - acts as a one-stop shop and a coordinating institution between the different agencies involved in the registration process. It allows entrepreneurs to register free of charge and in a timely and efficient way and can also deal with all other company statutes (trader, limited liability company, SA, etc.).

These are the documents that can be obtained via GUFE one-stop shop:

- Registration number with the Caisse Nationale de Sécurité Sociale (CNSS);
- Unique Tax Identifier (IFU) from the Direction Générale des Impôts et Domaines (DGID);
- Certificate of registration in the Trade and Personal Property Credit Register (RCCM);
- A certificate of registration from the Direction Générale du Travail (DGT).

Where appropriate, the GUFE also provides assistance in obtaining a company or importer card; issues legal notices; and validates legal statutes. As an additional measure to assist SMEs, GUFE counters also include ATMs.

The status of entreprenant can apply to a natural person who runs a micro or small business carrying out any type of activity. Formalization with this new status is easy, free of charge and takes only one working day.

Benefits of formalizing as an entreprenant in Benin:

- Free of charge;
- One-day registration (applies to other status);
- Tax exemptions after formalization - Businesses that formalize, registered with CGA, and that had not paid taxes before, have a tax exemption for the first year after formalization, in addition to a reduction of 40 per cent in the amount of taxes due for the following 3 years.
- Open a Business Bank Account;
- Apply to bank loan;
- Working with large companies;
- Chamber of Commerce Registration;
- Provide invoices to customers for tax purposes.


6 Founded in 1993, OHADA has 17 members in West and Central Africa: Benin, Burkina Faso, Cameroon, Central African Republic, Comoros, Congo, Cote d’Ivoire, Gabon, Guinea, Guinea Bissau, Equatorial Guinea, Mali, Niger, Democratic Republic of Congo, Senegal, Chad and Togo.
Box 3: Chile: Digital business start-up and compliance formalities

In 2012, despite a long period of economic growth and a conducive business environment, 48 per cent of companies in Chile had not yet formalized. The PYME Statute (SME statute; Law 20,416) of 2010 established the normative framework for promoting and encouraging the formalization of small businesses. The Chilean government then created three digital platforms to facilitate business start-up and ongoing compliance formalities.

I. Escritorio-Empresa (Enterprise Desk) is a virtual window. It caters for the needs of enterprises at the various stages of their life-cycle. The platform, which was launched as a joint initiative by the Production Development Agency (CORFO) and the Ministry of Economy, describes all types of procedures and information related to the start-up and operation of enterprises. It also provides entry to various useful institutions and offers tutorials on enterprise creation. It is possible to compete for public funds for enterprise start-ups, operation and particularly for innovation and development. It is also possible to apply for credit and to open a current account. In 2018, participation in the platform included 23 State institutions, 200 municipal authorities and three banks, through which 70 types of procedures could be carried out. (See: https://www.escritorioempresa.cl/)

II. The PreviRed online platform brings together all the public and private institutions that constitute the Chile's social security system. It aims to enable enterprises, employers of domestic workers and own-account workers, to electronically declare and/or pay their social insurance contributions through a single or interactive payment. The platform brings together contributions for pensions, health, employment injury, family allowances and unemployment insurance, and automatically calculates their amount for each worker and each payroll or workforce. It is connected to all financial banking institutions and some non-banking institutions, such as credit card companies to facilitate online payments. PreviRed provides a flexible online 24-hour service that is free of charge.

Prior to the creation of the portal, employers had to fulfil a large number of social security procedures with multiple institutions. With the creation of PreviRed, the complexity of the procedures and the transaction costs have been substantially reduced, saving time and providing a flexible 24-hour service which is free-of-charge.

III. Empresa en un Dia simplifies enterprise registration through a platform established by the Chilean Ministry of Economy, Development and Tourism. Registration in the Business Registry, the public deed and the publication in the Official Gazette can be completed by filling out a digital form. Since 2013, more than 70 per cent of companies have been created through this digital platform. The company can start operations immediately upon receipt of the tax identification number assigned by the platform.

In addition to these platforms, the Chilean government created in 1952 the Servicio de Cooperación Técnica - Technical Cooperation Service - SERCOTEC. SERCOTEC is a private corporation established under the Ministry of Economy, Development and Tourism which is dedicated to the productive development of micro- and small enterprises as well as the formalization of enterprises.

Some examples of SERCOTEC's programmes:

- Support services intended to build capacity like Business Development Centres; strengthening of Commercial Zones; Virtual training and Legal advice; SME Support Services and Information Points. There has been a significant focus in these programmes on formalization and they assisted 137,540 entrepreneurs throughout the country in 2017.
- Direct resource transferring - Capital Semilla (‘Seed Capital’) and Capital Abeja Emprende (‘Enterprise Bee Capital’); Fondo Crece (‘Growth Fund’); Fondo Mejora Negocios (‘Business Improvement Fund’) and Fondo de Asesorías Empresariales (‘Entrepreneur Advisory Aund’); Almacenes de Chile (‘Chile Stores’); Fondo de Ferias Libres (‘Free Fairs Fund’); and Apoyo a Fortalecimiento de Gremios (‘Branch Strengthening Support’). Several of these programmes support formalization processes.


Thematic brief Enterprise Formalization: An Introduction (No. 1/2021) provides more information on how to facilitate a transition to formality and how to identify various sub-segments of economic units.

Thematic brief Enterprise Formalization: Tailored registration, tax and social security requirements for MSEs (No. 3/2021) identifies some regulatory reforms that may make it easier and more attractive for small economic units to formalize.
Further reading/resources


Enterprise Formalization: An Introduction
Thematic Brief No. 1/2021

Enterprise Formalization: Simplifying and facilitating business start-up and compliance
Thematic Brief No. 2/2021

Enterprise Formalization: Tailored registration, tax and social security requirements for MSEs
Thematic Brief No. 3/2021