

PANEL/TRACER STUDY ON THE IMPACT OF BUSINESS FACILITATION PROCESSES ON MICROENTERPRISES AND IDENTIFICATION OF PRIORITIES FOR FUTURE BUSINESS ENABLING ENVIRONMENT PROJECTS IN LIMA, PERU

Project Summary

Many microbusinesses in Lima, Peru, operate without municipal licenses because the licensing process is lengthy and brings them to the attention of tax authorities. An effort was made to gauge whether streamlining procedures would encourage more companies to get licenses and whether that would boost economic development through production of higher-quality goods and services. Prior efforts in Mexico to reduce the number of days and requirements for obtaining a license worked relatively well and an effort was made to repeat the finding in Peru.

What IFC expected

Making it easier and less time-consuming to get a license would allow small firms to get credit more cheaply, gain increased legal protection, and have a better chance at expanding by teaming up with bigger firms. Providing incentives for applicants could encourage more to seek licenses and potentially to increase their output.

What happened and why

A group of 32 unlicensed microbusinesses was selected to judge why they preferred to operate informally, or without licenses. All had fewer than six employees, most were led by women, and 21 were rated as precarious because they generate low income and are in a generally fragile condition. Most saw no benefit in obtaining a license because of their low operating scales and the costs of doing so. Owners of such subsistence operations may not operate by normal entrepreneurial rules for a variety of reasons, including the small scale of their operations and their perception of the economic situation, and so do not make the connection between investment and increased consumption that might be expected. Some of them cited benefits from operating informally, because the businesses thereby avoided paying taxes and skipped paying the costs of health and safety regulations. A typical response from a microbusiness owner, operating at subsistence level, was to question what advantage would be gained by holding a license, since income was so low that the owner would never qualify for a bank loan anyway. Even when the municipal government cut the time for obtaining a license to two days from 160 and reduced inspections, the busi-

nesses did not apply for licenses, even when it became cheaper for them to do so. Further study found that while some small businesses that held licenses were good performers in terms of their incomes and profits per worker and their investments in machinery, there was no evidence to link the act of having a license with the stronger performance. In addition, municipal authorities showed a lack of understanding about the potential of small subsistence businesses and the need to make licensing procedures simpler for them, expressing doubt the businesses would be able to pay a license fee in any event. Some small businesses that were prepared to seek licenses complained that municipal inspectors' requirements were excessively rigid and costly. For example, the owner of an Internet booth business with eight computers was required to have a ground well to qualify and felt that was unnecessary.

Lesson for future operations

Removing administrative barriers and lowering costs of licensing for microbusinesses do not induce more to operate according to law, because many of them are subsistence operations so fragile that they do not perceive any benefit from holding a license. Many are family-operated, see scant possibility of being able to increase the size of their businesses in the near future, and often wish to avoid the taxation that would follow from licensing. Reducing costs for a license might not induce more to seek licensing, since owners of many microbusinesses, operating in a survival economy, are primarily concerned with whether the business itself will survive long enough to require and benefit from a license. A focus on social programs aimed at developing work skills and improving employment opportunities for younger members of families involved in microbusinesses might help these businesses acquire the skills needed to grow and enter the formal economy by obtaining a municipal license. Local governments might link actions like establishing support programs for older family members in microbusinesses by making it a condition that they bring their businesses into compliance with safety and other regulations. Improving municipal services such as social security and policing, and encouraging small businesses with low interest credit through the banking system or by conditional credits, could overcome distrust and persuade more to seek licenses and consider expanding operations.

Related lessons

- Small business owners are more reluctant to seek licenses, and to pay fees for them, if they perceive municipal authorities failing to supply adequate safety, sanitation, and other services
 - Widespread lack of knowledge about how to apply for a license implies that local governments need to publicize measures they are taking to make it easier to become licensed and set out the benefits that stem from licensing in order to create enthusiasm
 - Linking a campaign explaining how microbusiness owners can become licensed to the offer of training and other services intended to help them expand operations could offer the dual benefit of providing the training and increasing trust in municipal authorities
- It can be difficult to distinguish subsistence businesses from growth-oriented microbusinesses and small firms that might be more responsive to policies aimed at encouraging them to seek licenses. Developing measures for identifying the businesses' respective level of development would help in tailoring programs that encourage the more developed to seek entry into the formal economy through licensing.



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