

## MAKING IT EASIER FOR WOMEN IN MALAWI TO FORMALIZE THEIR FIRMS AND ACCESS FINANCIAL SERVICES

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### KEY MESSAGES

- **The rate of informal firms is high in Sub-Saharan Africa, especially for those that are women-owned and in the poorest countries, despite a total of 107 business regulatory reforms recorded by Doing Business across 40 economies in the region.** Through an experiment in Malawi, we established an effective and replicable design to offer informal firms support to formalize, costing much less than the typical private sector development intervention.
- **The study shows that one of the primary barriers to registration for women-owned firms is transaction costs. When registration is made virtually costless, an overwhelming number of women-owned firms (73%) choose to register.** However, when offered the chance to engage in costless registration for taxes, almost no firms select to pursue this option.
- **Combining business registration with an information session at a bank including the offer of a business bank account leads to an increased use of formal financial services, and results in increases in women-owned firms sales and profits of 28% and 20% respectively.** On the other hand, business registration on its own is not as effective in improving access to financial services and does not result in enhanced sales and profits.

### GENDER INNOVATION LAB

The Gender Innovation Lab (GIL) conducts impact evaluations of development interventions in Sub-Saharan Africa, seeking to generate evidence on how to close the gender gap in earnings, productivity, assets and agency. The GIL team is currently working on over 70 impact evaluations by more than 25 countries with the aim of building an evidence base with lessons for the region.

The impact objective of GIL is increasing take-up of effective policies by governments, development organizations and the private sector in order to address the underlying causes of gender inequality in Africa, particularly in terms of women's economic and social empowerment. The lab aims to do this by producing and delivering a new body of evidence and developing a compelling narrative, geared towards policymakers, on what works and what does not work in promoting gender equality.

Developing country governments seek to reduce the pervasive informality of firms for multiple reasons: increasing the tax base, helping firms access formal markets and grow, increasing the rule of law, and as a means to obtain data that can be used for other government functions. However, while governments may desire firms to become formal, firms may find these reasons much less compelling. Registering for taxes will impose additional costs on businesses, lowering profits, and firms may believe they receive few public goods in return. The result is that when firms weigh the potential benefits of formalizing against the costs, most may choose to be informal.

The standard government response to this firm comparison of the costs and benefits of formalization has been to lower the costs of formalizing, and to separate the process of business registration from that of tax registration. However, there is little evidence as to whether these methods are efficient in encouraging firms to formalize, and whether formalization can help increase sales and profits.

## SO WHAT TO DO ABOUT IT?

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, in collaboration with the Global Practice for Finance, Competitiveness and Innovation and the Development Research Group, launched an experiment to identify the impacts of different types of formalization assistance.

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.

<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).

## BUSINESS REGISTRATION ASSISTANCE



When we offer assistance on registration, which brings the costs close to zero, **a large majority (73%) of the women-owned firms register their businesses**



Combining registration assistance with a bank information intervention leads to even **higher levels of formalization (83%)**

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## HERE'S WHAT WE DID

This study tested three alternatives for how governments can bring firms into the formal sector, with over 3,000 informal firms in Malawi, of which 40% were women-owned: (a) assisting firms to obtain a business registration certificate that offers access to formal markets but imposes no tax obligations; (b) assisting firms to obtain business registration and tax registration; and (c) supplementing the assistance to obtain business registration with a bank information session intended to help firms utilize one of the key potential benefits of formalizing.

In this study we target the informal micro and small enterprises that are likely to be able to benefit the most from business registration.

## HERE'S WHAT WE FOUND

We find the existing transaction costs of registering a business are enough to deter the average firm from doing so. When we offer assistance, which brings the costs close to zero, a large majority (73%) of women-owned firms register their businesses—compared to 7% of the women-owned firms that did not benefit from this assistance. This goes against the assumption that firm registration is low because entrepreneurs *do not want* to register their firms. However, the disincentive to register for taxes outweighs any potential benefits of registering, even when transaction costs are removed: the take-up of our offer of assistance for tax registration was around 5%, and was not statistically significant. This could be relevant for efforts to formalize firms in some countries in Africa that do not separate business and tax registration.

On its own, registration brings no discernable impacts on profits and sales for women entrepreneurs. However, combining registration assistance with a bank information intervention not only leads to even higher levels of formalization (83%), but also to meaningful increases in the use of financial services and, ultimately, firm sales and profits (28% and 20% respectively). In particular, we find that women-owned firms are 35 percentage points more likely to have a business bank account after receiving both registration assistance and the bank information session, whereas we find no significant impact of the registration assistance alone on the creation of a business bank account. Findings show that access to the formal banking system enabled women entrepreneurs to be less credit constrained - the firms that benefited from registration assistance and from the information session were 600% more likely to have insurance, a large increase given that approximately 1% of the firms initially had insurance for their business.

## ACCESS TO FINANCIAL SERVICES & EFFECTS ON SALES AND PROFITS



Combining business registration with an information session at a bank including the offer of a business bank account leads to an increased use of formal financial services



and results in growth in firm sales of 28%, and growth in profits of 20%



On the other hand, **business registration on its own is not as effective** in improving access to financial services and does not result in increased sales and profits





Therefore, it appears that transaction costs are not the only barriers that prevent formalization from contributing to firm growth. Greater financial inclusion, with access to credit and other formal financial services is likely one of the main driving factors behind the increase in sales and profits. This highlights that the benefits of formalizing are not automatic for women entrepreneurs, but that additional policy efforts, such as helping firms gain access to the formal banking system, are needed to help firms take advantage of them.



## POLICY IMPLICATIONS

**At a one-time cost of \$27 per firm registered, this is an effective and replicable design to offer informal firms support to formalize, in a substantially cheaper way than many other government business support programs.**

Additionally, the combination of registration assistance and bank information session have the same (positive) effects on levels of business performance for women as it does for men. This is in contrast to small business grants and training interventions which have often struggled to be effective in growing women-owned firms.



For governments seeking to increase economic growth and achieve gender equality, reducing the costs of registration and coupling it with interventions that increase direct contact with formal financial institutions provide one compelling option.

**For more information on this study see the Policy Research Working Paper:**

<https://openknowledge.worldbank.org/handle/10986/30510>

FOR MORE INFORMATION,  
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