

Researchers

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Timeline

2019

Sample Size

804 micro-enterprises

Research Implemented by IPA

Yes

Promoting Business Formalization through Information Outreach in Colombia

Abstract

More than 60 percent of global workers are employed in the informal sector, facing more challenges and risks than their formal sector counterparts. While governments and organizations have implemented programs to encourage formalization, progress is slower than hoped in Colombia. Researchers studied whether access to information promoted formalization in a low-income community. The results suggest small and positive, but generally non significant effects of the intervention on business formalization, and more substantial impacts on perceptions of the costs and benefits of formalization. More research is needed to generalize these findings and clarify the underlying mechanisms. Plans for conducting a larger-scale evaluation in Bogotá are underway.

Policy Issue

Micro and small enterprises contribute significantly to developing economies, especially as a primary source of employment. However, between 40 and 80 percent¹ operate in the informal sector with higher challenges and risks than those in the formal economy. Extensive studies have documented how informal sector workers cannot access financial services, unemployment insurance, and in most cases, labor protections. Informal businesses also often lack access to credit, loans, and government programs that could help them grow and expand. They are also more exposed to fines and other abuses associated with informal markets.

Business formalization has emerged as a priority for many countries as it improves working conditions, enhances the business environment, and fosters economic growth. Many

approaches try to promote formalization by reducing associated costs, grant incentives, and information dissemination campaigns. However, little rigorous evidence exists to evaluate whether these actions help enterprises make the transition. This research sheds light on the role of information outreach in promoting business formalization.

Context of the Evaluation

Thirty percent of micro-enterprises located in major Colombian cities are not registered, and 33 percent of informal businesses do not know how to formalize². Over the last two decades, Colombia's government has attempted to reduce these percentages by lowering the cost of formalization, creating chambers of commerce to promote registration, increasing capacity for inspection and enforcement, and more actively supporting formal business. Despite these efforts, a recent study found that most micro and small enterprises in Bogotá do not know about business licenses, and over 10 percent wrongly assumed they had already formalized.³

This study took place in Altos de Cazucá, a community south of Bogotá with low formalization rates and low socioeconomic status. Each of the 16 barrios in the study holds approximately 50 micro-enterprises, with an average of 1.9 employees and US\$2 weekly profits.

Details of the Intervention

Researchers implemented a randomized evaluation to measure the impact of reducing transaction costs via information dissemination, with and without an offer for business development support, on formalization rates. Eight hundred and four micro-enterprises were randomly assigned to one of three groups:

1. Direct Outreach (293 microenterprises): Businesses received an in-person visit by a trained agent who encouraged formalization by sharing information about the potential benefits of registering and providing a detailed explanation of the process and required documentation.
2. Direct Outreach & Business workshop (242 microenterprises): In addition to direct outreach, the agent provided an invitation to a future business development workshop covering marketing, contracting, strategy, and legal support plus more detailed assistance for formalization.
3. Comparison group (269 microenterprises): no intervention.

The intervention was implemented between February and April 2019. The research team used administrative data and conducted a final survey in April 2019 to collect information on rates and perceptions of formalization, taxes, business performance, and access to financial services.

Results and Policy Lessons

The study found a small and positive, but generally non-significant impact of the interventions on formalization rates. The interventions did impact perceptions of the costs and benefits of formalization. Specifically, the microenterprises that participated in the program perceived that informal businesses are more likely to be detected and punished by the government.

The analysis is ongoing and further results are forthcoming.

Sources

¹ International Labor Organization (ILO), “Women and Men in the Informal Economy.”

² Asociación Nacional de Instituciones Financieras, “Gran Encuesta a Las Microempresas.”

³ Galiani, Meléndez, and Navajas, “On the Effect of the Costs of Operating Formally.”

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