



Formalization of Enterprises in Senegal, Benin, and Burkina Faso: Segmentation Approach to Informal Entrepreneurs

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Abstract

This paper aims to identify the determinants of business formalization in West Africa, specifically in Senegal, Benin, and Burkina Faso. The methodology used is based on a theoretical model on formality and a Logit model. We adopted the segmentation approach of informal entrepreneurs. We distinguished between the ambitious informal entrepreneur and the default or non-ambitious informal entrepreneur. In the three countries studied, the results showed the importance of access to business premises, firm productivity, and the ambition of the informal entrepreneur on formalization. The age of the firm, access to ICT, and

the business environment have a significant influence on formalization only in Benin. The average level of education for employees is significant only in the case of Senegal.

Introduction

In recent decades, the issue of informality has attracted a resurgence of interest among development researchers due to its increasingly recognized importance in the development process of countries, particularly in Africa (Mbaye & Benjamin, 2012). The informal sector has been prominent in the economies of developing countries and is increasingly affecting those of developed countries despite government policies on formalization (Chen, 2001; Enste & Schneider, 2002). The trend of informal enterprises accounts for the emergence of a large literature on informality. This varied literature deals with conceptual analyses as well as theoretical and empirical modelling. In the 1970s, researchers defined the informal sector based on some criteria, namely the nature of the activity, destination of their production, size of the operation, compliance with regulations, qualifications of the workforce, and access to modern financing (BIT, 1972; Sethuraman, 1976). These early attempts define the informal sector in contrast to the formal sector. They, therefore, ignore the interrelationships between these two sectors of the economy. Charmes (1990) argues that this dichotomy makes the analysis easy. In this paper, we refer to the multi-criteria approach developed by Mbaye and Benjamin (2012). Mbaye and Benjamin (2012) define informal enterprises as a continuum in which many formal enterprises engage in informal practices. They show that none of the commonly cited criteria exactly defines an informal enterprise. In other words, taxation, size, bookkeeping, registration, access to credit, and type of premises do not individually characterize the informal enterprise. They conclude that each of these criteria covers a particular aspect of informal enterprises, and ignores the phenomenon, suggesting that informal enterprises are best described as a continuum through a combination of different criteria. In this paper, enterprises that do not meet these criteria are considered informal.

Informality generates much of the wealth in West African countries. The informal sector provided 50.41% of GDP in Burkina Faso, 54.2% of GDP in Benin, and 44.9% of GDP in Senegal in 2011 (national accounts). Indeed, in Senegal, the informal sector created 92.1% of total employment in 2003 (DPS, 2003). In Burkina Faso and Benin, too, informal employment has a considerable share in total employment, accounting for 94.7% and 94.9%, respectively, in 2005 (INSD, 2009; INSAE, 2013). However, informal enterprises are mainly composed of small-scale production units that develop mainly subsistence activities that bring in little income, are low in productivity and are very labour-intensive. They have limited access to financial and technological resources but allow the population excluded from the formal labour market to survive in the socioeconomic context of developing countries marked by a lack of safety nets. However, it is worth noting that informal enterprises are far from being homogeneous.

Informal entrepreneurs do not behave in the same way. A variety of behaviours can be observed in informal entrepreneurs. While some aspire to formalize their activities over time, others prefer to remain informal. Some informal entrepreneurs are active in the sector simply because they have no other options and are considered 'default' or 'unambitious' entrepreneurs. Other entrepreneurs are 'ambitious' and motivated to stay in the sector to grow their businesses. The latter would be willing to enter the formal sector with the support of the State. The ambitious entrepreneur is an individual who engages in an entrepreneurial project to achieve performance beyond the mere survival of the business created in a competitive environment (Edwards et al., 2012). They analyse the market and set performance targets. What distinguishes ambitious informal entrepreneurs from other informal entrepreneurs is their intention to develop their business, expand it, and make profit out of it. Verheul and Van Mil (2011) measure 'ambition' not in absolute terms, but based on what the entrepreneurs want, whether they prefer a business that is as large as possible or a business with a size that allows them to run the business alone or with a few key employees. The issue here relates to the segmentation of informal entrepreneurs. We define the ambitious informal entrepreneur as one whose intention and commitment stems from their goal to leave their business to their children at a sufficient organizational and performance level.

As part of its policy for a business environment conducive to informal enterprises, the Beninese Government has set up a ministry in charge of industry and crafts. Within this framework, it has worked for the promulgation of the handicraft law and has put in place a real policy for the development of handicrafts in Benin. This policy has taken concrete form with the development of the nomenclature of craft trades and the establishment of interdepartmental chambers of crafts and the union of interdepartmental chambers of crafts. To this end, other initiatives such as the creation of a national fund for the promotion of handicrafts are a catalyst for the development of handicrafts, which is one of the important links in the chain of informal enterprises in Benin. In Burkina Faso, a proper financial system for boosting informal enterprises has been set up, including the Support Fund for the Informal Sector (FASI) and Support Fund for the Promotion of Employment (FAPE). While in Senegal, many initiatives have been implemented to improve business environment for SMEs, and more particularly for informal enterprises; these initiatives have taken the form of support agencies for small and medium enterprises attached to the respective ministries. This is the case with the Agency for the Promotion and Development of Handcraft (APDA), attached to the Ministry of Industry and Handicrafts, and the Agency for the Development and Support of Small and Medium-sized Enterprises (ADEPME), which is attached to the Ministry of Small and Medium Enterprises, Women's Entrepreneurship and Microfinance. Created in November 2001, ADEPME expresses the Senegalese Government's interest in supervising small and medium enterprises, particularly informal enterprises.

Some authors (De Soto, 2000; Djancov et. al., 2002; Loayza and Serven, 2005) have sought to explain the informal situation of entrepreneurs. They have shown that it may depend on the high costs of reporting formalities and taxes, which prevent entrepreneurs from entering the formal sector. However, it should be kept in mind that there are different behaviours between ambitious and default entrepreneurs. This paper aims to identify the determinants of business formalization in West Africa in the cases of Senegal, Benin, and Burkina Faso. The main contribution of this paper is the adoption of the segmentation of informal entrepreneurs with, on the one hand, 'ambitious' informal entrepreneurs and, on the other hand, those 'by default'. In the field of investigation considered, the empirical analysis for the determinants of formalization considering the segmentation of entrepreneurs remains insufficient. This segmentation approach could enable governments to understand better the typology of informal entrepreneurs and to factor in those aspects regarding the development of their enterprise formalization policy. Any work on the determinants relating to formalization should emphasize on considering these notions of the ambitious informal entrepreneur. The methodology used revolves around a theoretical model and a Logit model. The World Bank and AERC databases on formal and informal enterprises (2013) were used.

Data source

In this study, we use the database on formal and informal enterprises in West Africa, which African Economic Research Consortium (AERC) and the World Bank developed in 2013. In Senegal, AERC conducted the survey. The National Institute of Statistics and Population (INSD) conducted the survey in Burkina Faso, and the National Institute of Statistics and Economic Analysis (INSAE) in Cotonou, Benin. AERC assumed the overall coordination of the three surveys. As the main objective was to carry out logistic type analyses, the approximation of the margin of error would be proportional to $1/\sqrt{n}$. The surveys were conducted simultaneously in the capital cities of each country involved. The sample contains 903 enterprises of which 295 are in Benin, 308 in Senegal, and 300 in Burkina Faso. Regarding the types of enterprises, Benin had 22.7% formal and 77.3% informal; Senegal had 24% formal and 76% informal, and Burkina Faso had 13.3% formal and 86.7% informal enterprises. We used the probability sampling method.

Conclusion and policy recommendations

This study focused on the analysis of the business formalization determinants in Senegal, Benin, and Burkina Faso. The theoretical model used is that of Lucas (1978) based on the theory of the distribution of the commercial enterprise size and expanded through by Rauch (1991) on the theory of formality, and by Gelb et al. (2009) on the probability of being formal entrepreneur. The empirical model used is a Logit

model. In the empirical model, we segmented the entrepreneurs into two categories: the ambitious informal entrepreneur and the default informal entrepreneur.

The results showed the importance of the variables of access to business premises, firm productivity, and entrepreneurial ambition on the probability of being formal in the three countries studied. The age of the firm, access to ICT, and the average duration of interruption of social services have a significant and positive influence on formalization only in Benin. The average level of education of employees is only significant in Senegal. We also found that the gender of the entrepreneur has no significant influence on the probability of being formal in any of the countries considered in the study. The sector of activity is significant in both Senegal and Benin. As for the size of the firm, it is significant in Senegal and Burkina Faso.

Regarding policy recommendations, the governments of the countries concerned should develop policies to improve the productivity of informal enterprises. Emphasis should be placed on the considerable improvement of human capital through vocational training (trade chambers promotion, initiation of capacity building programmes, and promotion of distance and evening learning). States should also make efforts to improve the business environment and facilitate access to basic public infrastructure. Finally, governments should ensure that there are entrepreneurs that are more ambitious. This will require a government policy that allows informal entrepreneurs to access a larger client base, partnership opportunities, public tenders, and social security coverage.

The main limitation of this work is the lack of a strong coverage of recent (less than five years) formal and informal enterprises in the database. This coverage would allow us to distinguish differences in the effect of explanatory variables on the probability of being formal between recent and old entrepreneurs.

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