



International
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Enterprise
Formalization

CASE STUDY
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▶ Progressive access to finance and support to encourage enterprise formalization

Experiences from
Egypt and Chile

This document is part of a series of case studies by the Enterprises Department of the ILO. Each case study presents one or several approaches that contribute to enterprise formalization across the world. The case studies provide a snapshot on a particular initiative and may not be exhaustive.

Making formalization financially attractive can be a strong incentive for entrepreneurs to gradually formalize their business. One way to do this, is by encouraging formalization through blended finance, where the size of loans is conditional on the gradual transition into the formal economy and where locally adapted formalization support such as training or information-sharing is provided. Making formalization easier and financially attractive can be implemented by financial service providers in the private and public sector, as shown in the two examples from Egypt and Chile.



1. What was the initial situation?

Due to the lack of a formal status of enterprises in Egypt and Chile, most of them did not possess bank accounts and lacked access to relevant and affordable financial services.

In **Egypt**, the employment statuses with one of the highest percentage of informality are employers and own-account workers. Enterprises in the informal sector provide 62.2 per cent of total employment. **Alexandria Business Association Small and Medium Enterprises (ABA-SME)**¹ was created in 1990 as a comprehensive credit scheme and became one of the leading microfinance institutions in the country and MENA region. It conducts advocacy and provides business development as well as social services.

In **Chile**, BancoEstado is the country's only state-owned commercial bank with full coverage of national communes and it is the third largest bank in Chile. In

2004, a branch specializing in micro-enterprises was created, the **BancoEstado Microempresas (BEME)** which is the State Bank Filial for Micro-enterprises. Its mission is to promote access to financial services for this segment of enterprises with complementary capacity building programmes. At the end of 2020, BEME had a portfolio of 774,540 micro-enterprise clients, with a share of 34.5 per cent female-owned businesses.² Of these clients, around 37 per cent are accessing some type of financing from the bank. The bank offers various products for micro-enterprises, such as loans, accounts, financial advice and business development support across different service platforms. In order to better align the service provision to micro-enterprises, the bank categorises them into 28 productive segments such as Commerce, Transportation, Trades, Manufacturing, Agricultural Services, Tourism and Fishing.

2. What were the solutions?

To encourage entrepreneurs to formalize and access credit, **ABA-SME** adopted a "graduation" approach which also encouraged formalization through blended finance, based on a credit incentive scheme. It provided conditional grants, soft loans and a progressive scheme encouraging entrepreneurs to get in contact with formal institutions and driving

formalization by a credit incentive scheme. This means that the entrepreneurs could gain access to larger loans if they met more stringent formalization requirements. In addition, ABA-SME invited staff from financial and non-financial institutions to its workshops in order to explain the requirements and the benefits of formality, which helped create a relationship



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► Issues for entrepreneurs with respect to accessing financial services

Egypt	Chile
<ul style="list-style-type: none"> ► A demanding control system to enforce formality and high penalties in case of non-compliance, that led to some business closures ► Absence of constructive linkages with public institutions ► No perceived incentive to formalize 	<ul style="list-style-type: none"> ► 94% of Microbusinesses did not have bank accounts registered in their name, as they had difficulties in complying with requirements related to the minimum number of years of operation, the provision of cash-flow statements, and due to limitations on outstanding debts

1 The Alexandria Business Association (ABA) is affiliated to the Egyptian Employers' Organization.

2 BancoEstado (2020). [Integrated Annual Report 2020](#).

between civil servants and ABA's clients. Loan officers supported ABA-SME clients to comply with additional requirements and documentation. This was also facilitated through the creation of three one-stop shops, in collaboration with civil servants that could provide temporary licenses until the permanent licenses were issued.

BancoEstado Microempresas helped customers to formalize by providing information and training on the procedures involved. Depending on the type of training support, emerging informal enterprises are eligible to receive finance, however, access to a second loan, an increase in the loan and the provision of other financial products were conditional upon the formalization process. It accordingly provided a series of online training programmes to facilitate formalization, and promoted the collaboration of its clients with the micro-enterprise support services provided by development, training and market access institutions, such as the SERCOTEC Business Development Centres and Chile Compra, the public procurement agency to improve enterprise performance.

In 2013, BancoEstado MicroEmpresas launched the entrepreneur's account (Cuenta Emprendedor), as a new product which helps newly registered micro and small enterprises to manage their finances. It allows these businesses to safely and easily manage their finances, reducing the risk of loss or theft. To be able to open the account the bank only requires the company's operating license and tax registration papers, together with the documents identifying its legal representatives. This financial product clearly reduces the costs of complying with bookkeeping requirements and regulations and offers an incentive for businesses to formalize as only registered micro and small enterprises can make use of the service.

3. What were the results?

In **Egypt**, ABA-SME did not monitor per se nor report formalization of new clients, but the organisation indicated that by 2016, 18 per cent of client businesses were formal – meaning that they at least complied with the tax declaration requirements. The intervention improved mutual trust between micro-entrepreneurs and public institutions, as the higher the loan amount, the more micro-entrepreneurs were encouraged to tighten their relationship with these institutions. A growing number of clients moved to the more stringent lending modalities as their enterprises grew over time. Not only were access to loans and repayments overall improved for micro-enterprises, but over 12 per cent of the client base graduated from group lending methodologies to the bank's SME lending programme.

In the first two months after the launch of the entrepreneur's account by **BancoEstado MicroEmpresas**, more than 700 micro and small companies opened an entrepreneurs' account. In 2020, the number of entrepreneur accounts reached about 175,000. The country has registered satisfactory progress in micro and small enterprises' access to formal credit, which has eased the transition to formality for many firms.

► Table 1. Formalization steps and related loan sizes

Loan Size	Requirements
L.E. 7,500 (US\$ 1,315)	Personal ID Card A fixed business address
L.E. 7,500 (US\$ 1,315)	Ability to read & write
L.E. 10,000 (US\$ 1,754)	Tax Card
L.E. 12,500 (US\$ 2,193)	Social Security Certificate
L.E. 15,000 (US\$ 2,632)	Bank Checking Account
L.E. 20,000 (US\$ 3,508)	Financial Statement for the Business + Tax Statement

Source: Gachet, N. & Staehlo, V. (2008).

4. Lessons learned/key take aways

Beyond providing **financial incentives** to entrepreneurs, targeted **training** and support and the adoption of a step-by-step approach to encourage entrepreneurs to **familiarize themselves with public institutions and formalization processes**, was instrumental. By increasing the benefits of formalization, ABA-SME and Banco Estado MicroEmpresas contributed to making enterprises more sustainable and the cost of formalization more affordable. As a result, the cost/benefit ratio of formalization was perceived as positive and informal entrepreneurs were able to progressively formalize their enterprises, increase their access to finance and operate in the formal economy. This may enable these formalized enterprises to seize new business opportunities and operate more sustainably.

In Chile, additional interventions contributed to reducing informality, such as the creation of guarantee funds (e.g. the Fondo de Garantía para Pequeños Empresarios -FOGAPE) and the simplification of MSE taxation. These were introduced together with a virtual office offering electronic accounting software and billing service, and support to SMEs to access public and private procurement opportunities.

5. Resources

- 🔗 Gachet, N. & Staehlo, V. (2008). [Formalisation through micro-finance: an empirical study in Egypt](#), International Labour Organization, Geneva.
- 🔗 ILO (2014). [Policies for the formalization of micro and small enterprises in Chile](#). FORLAC Notes on Policies for the Formalization of Micro and Small Enterprises.
- 🔗 ILO (2019). [Formalization: The case of Chile](#), Report.

Websites:

- 🔗 Alexandria Business Association (ABA): www.aba-sme.com
- 🔗 BancoEstado Chile: www.bancoestado.cl; www.corporativo.bancoestado.com

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