

INFORMAL SMEs in BANGLADESH: FORMALISATION CHALLENGES and WAY FORWARD



Informal SMEs in Bangladesh: Formalisation Challenges and Way Forward

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Foreword from SME Foundation

SMEs are the backbone of Bangladesh's economy, with considerable contributions to GDP, employment, and poverty alleviation. However, many of these enterprises have operated informally, out of the sight of regulatory frameworks, excluding them from opportunities to enhance growth, finance, and capacity. Though vital, informal SMEs face various challenges related to access to credit, markets, technology, and institutional support, making them vulnerable and less competitive in a more globalized economy.

The report “Informal SMEs in Bangladesh: Formalisation Challenges and Way Forward” explores the multilayered and multifaceted nature of informal SMEs. Through research, this study identifies the bottlenecks these enterprises face in transforming themselves into a formal economy. It sheds light on motivational factors, structural impediments, and policy gaps that must be addressed to facilitate such transformation. The work underlines that a coherent strategy is mandatory and demonstrates how formalisation is critical to attaining sustainable economic development, decent employment, and the realization of the SDGs.

This study is a pragmatic mixed-methods approach that embraces quantitative and qualitative research to paint a full picture of the informal SME ecosystem. It amalgamates the results of surveys, focus group discussions, and in-depth interviews with stakeholders such as owners of SMEs, policymakers, academics, financial institutions, and development partners. With the help of econometric modeling, this report gives robust findings and actionable recommendations, considering global best practices in the unique socio-economic context of Bangladesh.

A notable strength of this report lies in its policy recommendations, which are firmly grounded in evidence. It advocates for the simplification of the formalisation process, with a reduction in administrative burdens, and for using digital platforms as a means to enhance the accessibility of registration. In addition, it recommends financial and non-financial incentives, like tax benefits, training programs, and market access initiatives, to stimulate informal SMEs toward formalisation. The report also emphasizes how important it is to address gender-specific barriers, particularly in the case of women-led SMEs while providing equal opportunity for all entrepreneurs.

It would not have been possible to perform this research without the valuable contributions of many individuals and organizations. We are grateful first to Prof. Dr. Melita Mehjabeen and Dr. Sadia Noor Khan, who spearheaded this effort, along with the research associates and contributors who worked in a manner so that the rigors and depth of this study could be ensured. We also appreciate Friedrich-Ebert-Stiftung (FES) Bangladesh and SME Foundation for the financial and logistical support extended and the policymakers, academics, and entrepreneurs who shared valuable input through focus groups and interviews.

This report is not an academic exercise but a call to action for policymakers, development practitioners, financial institutions, and owners of SMEs, who must all work in concert to formalise the informal sector. Formalisation is not mere compliance but a path toward unleashing the real potential of SMEs; their sustainability will be guaranteed as they integrate into the formal economy where they can flourish and make significant contributions to national development.

We hope this report serves as a source of inspiration for data-influenced and inclusive strategic planning that will empower these informal SMEs, thus enhancing their productivity and offering them a chance to transform Bangladesh's economic perspective.

Anwar Hossain Chowdhury
Managing Director

Foreword from FES Bangladesh

It is with great pleasure that we present this pivotal comprehensive research report on “Informal SMEs in Bangladesh: Formalisation Challenges and Way Forward,” conducted by FES Bangladesh in collaboration with the SME Foundation. This study, under the exemplary leadership of Prof. Melita Mehjabeen, PhD, Professor at the Institute of Business Administration (IBA), University of Dhaka, and co-researcher Sadia Noor Khan, PhD, Associate Professor in the Department of Banking & Insurance, University of Dhaka, supported by research associates Zeba Farzana and Khondokar Jilhajj, represent a significant step toward understanding the informal SME sector in Bangladesh. Informal SMEs play a vital role in the country's economy. Yet, they face numerous barriers that prevent them from realising their full potential. The report is a timely contribution to understanding these enterprises' challenges and how they can smoothly transition toward formalisation.

Formalisation refers to the process through which informal businesses—those not registered with the government or regulated by formal legal and financial frameworks—become part of the formal economy. Formalisation is not just about registering a business; it involves compliance with regulatory frameworks, paying taxes, accessing legal protection, and becoming eligible for formal financial services. This transition allows enterprises to access opportunities like credit facilities, government incentives, and participation in broader domestic and international markets.

The significance of formalisation extends beyond economic benefits; it also strengthens labour rights and ensures better working conditions, aligning with the International Labour Organisation (ILO) Convention 2006. Furthermore, formalisation is key to achieving the United Nations Sustainable Development Goals (SDGs), particularly Goal 8, which promotes decent work and economic growth. For SMEs in Bangladesh, formalisation is crucial for fostering a more inclusive and equitable economy.

This report sheds light on the motivations and challenges of formalising informal SMEs. Key drivers of formalisation include access to domestic markets, business growth, and capital, all of which are essential for an SME's development and sustainability. However, the report also highlights the numerous barriers SMEs face in this transition. These

include cumbersome regulatory processes, insufficient government incentives, a lack of awareness of the benefits of formalisation, and the social barriers that particularly affect women-owned businesses and other marginalised groups. Without addressing these challenges, the pathway to formalisation remains difficult for many enterprises.

The study provides actionable recommendations for simplifying these processes, such as streamlining registration and licensing systems, introducing targeted policies for informal sectors, and launching awareness campaigns to promote the advantages of formalisation. Additionally, collaboration between the public and private sectors is crucial. Learning from successful strategies implemented by countries like Vietnam, Malaysia, and India, Bangladesh has the opportunity to adopt a more structured and inclusive approach to formalising its informal SME sector.

We want to thank the research team for their dedication and invaluable contributions to this study. Special thanks are also due to the SME Foundation and the numerous experts and stakeholders who reviewed and refined the final report. Their input was crucial in shaping the research findings into a comprehensive and practical roadmap for policy implementation.

We sincerely hope this report will serve as a guiding resource for policymakers, researchers, and development practitioners. Bangladesh can unlock this sector's full potential by taking concrete steps toward formalising informal SMEs, fostering economic growth and ensuring a more resilient, equitable, and sustainable future.

Dr. Felix Gerdes
Resident Representative
Arifa As Alam
Programme Advisor

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List of Acronyms

Abbreviation	Full Form
ADB	Asian Development Bank
ADBI	Asian Development Bank Institute
ASEAN	Association of Southeast Asian Nations
BBS	Bangladesh Bureau of Statistics
BDT	Bangladesh Taka
BEPZA	Bangladesh Export Processing Zones Authority
BIDA	Bangladesh Investment Development Authority
BIDS	Bangladesh Institute of Development Studies
BRAC	Bangladesh Rural Advancement Committee
BRDB	Bangladesh Rural Development Board
BSCIC	Bangladesh Small and Cottage Industries Corporation
CMSME	Cottage, Micro, Small, and Medium Enterprises
COVID	Coronavirus Disease
CPD	Center for Policy Dialogue
CSME	Cottage, Small, and Medium Enterprises
FBCCI	Federation of Bangladesh Chambers of Commerce and Industry
FES	Friedrich-Ebert-Stiftung (German political foundation)
FGD	Focus Group Discussion
GDP	Gross Domestic Product
ICT	Information and Communication Technology
IDI	In-Depth Interview
IFC	International Finance Corporation
ILO	International Labour Organisation
KII	Key Informant Interview
LFS	Labour Force Survey
MFI	Microfinance Institution
MFS	Mobile Financial Services
MSME	Micro, Small, and Medium Enterprises
NASCIB	National Association of Small and Cottage Industries of Bangladesh
NBR	National Board of Revenue
NGO	Non-Governmental Organisation
NSDC	National Skills Development Corporation
OECD	Organisation for Economic Cooperation and Development
OLS	Ordinary Least Squares
PLS-SEM	Partial Least Squares Structural Equation Modelling
PWCCI	Patuakhali Women's Chamber of Commerce and Industry

RMG	Ready Made Garments
ILO-SAAT	ILO South Asia Multidisciplinary Advisory Team
SANEM	South Asian Network on Economic Modeling
SDG	Sustainable Development Goal
SMCIF	Small, Micro and Cottage Industries Foundation
SME	Small and Medium Enterprises
SMEF	Small and Medium Enterprise Foundation
SPSS	Statistical Package for the Social Sciences
SSC	Secondary School Certificate
TIN	Tax Identification Number
TOR	Terms of Reference
UCEP	Underprivileged Children's Educational Programs
UNDP	United Nations Development Programme
USA	United States of America
VAT	Value Added Tax
VECM	Vector Error Correction Model

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Executive Summary

The objectives of this study are to identify the current status of informal SMEs in terms of characteristics, types, size, employment, etc. in Bangladesh, the policy gaps, their motivations to transition to formalisation and the challenges or hurdles of formalisation and potential way forward

Formalization offers entrepreneurs significant advantages, such as improved access to capital, legal protections, and the ability to expand their business into new markets. For the economy, formalizing SMEs contributes to better job creation, greater tax revenue, and enhanced productivity, all of which fuel sustainable economic growth. Furthermore, the formalization of enterprises is essential for achieving the International Labour Organization's (ILO) mandate and the Sustainable Development Goals (SDGs), particularly the goal of "Decent Work." By formalizing employment structures, the country can ensure fair labour practices and a more equitable economy.

The study has collected data through questionnaire surveys from small enterprises to identify the factors which might motivate the SME to formalise their enterprise and the challenges of formalisation. The study used econometric models (logistic regression) to investigate the association of the chances of the identified motivating factors to the probability of formalising. While the survey identified few significant factors like financial incentives from the government, sales growth, and collaterals in case of access to finance to be significantly related to the probability of formalisation, an in-depth insight was gathered from FGDs and semi structured interviews with policymakers, regulators, academics and researchers, policy advocates, international development organisations etc. The researchers conducted 2 FGDs and 9 semi structured Interviews to get an in depth understanding of the challenges of formalisation of SMEs from the government officials, central bank (Bangladesh Bank), SME Department of private commercial bank, Development Organisations, research organisations, policy advocates, SME experts and economists and academics.

The study found access to domestic market, access to capital and business growth to be motivational factors for informal enterprises to formalise. Formalisation is inevitable from economic development perspective. At the same time, the government has been mandated by International Labour Organisation (ILO) Convention 2006 to formalise

the informal sector of Bangladesh. In addition to that, to achieve the SDG goal of Decent Work, the employment needs to be formalised and before employment, the enterprises will have to be formalised.

This study has identified several challenges of formalisation from both the SME owners' as well as the SME experts/ policymakers' perspectives. Cumbersome formalisation process in terms of registrations, acquiring trade license has been identified by all the participants as a deterrent factor for formalisation. The lack of policy for informal sector and informal enterprises was considered a hurdle and the need for policies for informal enterprise was also highlighted. From the SME owner's perspective, Lack of awareness of benefits of formalisation, lack of incentives and support from the government, and the fear of adopting to new environment after formalisation coupled with the freedom to operate without complying with any law or regulations are some of the challenges identified. One interesting insight in terms of social barriers was highlighted for marginalized namely women owned SMEs.

Based on the findings, some recommendations were suggested and eventually a validation workshop was conducted where the recommendations were presented. From the feedbacks received in that session, some recommendations have been highlighted below that can make the formalisation process seamless and more effective:

Highlighted Recommendations

- In order to have an effective and seamless formalisation process, the government should formulate a **Nationwide Strategy for Informal Sector Formalisation**.
- The government should involve **representation** and **collaboration** from stakeholders from both public and private sector and formulate a strategy **with short term, medium term and long action plans** to formalise the SMEs. The strategy should focus on the policies to be developed and formulated, identification of the roles and responsibilities of different institutions involved in SME development, the activities and programs to be undertaken, the targets to be achieved, assessment of the programs that help in the transitioning to formalisation, etc. The strategy must also cover post formalisation **upgradation** and **safeguarding policies** for the small entrepreneurs.
- While formalisation is a continuous process, the government should carefully plan and **target the opportunistic entrepreneurs** who have the potential to formalise and survive. Subsistence level entrepreneurs should not be targeted since the costs of formalisation might potentially outweigh the benefits.
- There should be a clearly defined **incremental formalisation** plan. The government might plan a **phase-by-phase** formalisation process. The phases might be based on clusters or sectors.
- The **paperwork and manual cumbersome formalisation process** must be **simplified**. An unfavourable overly complicated and manual process of formalisation makes the small enterprises reconsider their decision to formalise their businesses.
- **One Stop solution platform**, which has been successful in a number of countries like Malaysia, Singapore, Myanmar, and India should be introduced to avoid the manual and cumbersome registration process. At the same time, the responsible authority for providing the One Stop Solution should be empowered and monitored.

In order to implement the recommendations, it is necessary for the government and the private sector to collaborate and set the targets and priorities with specific timeline for a seamless formalisation process. Formalisation is the step towards accounting the contribution of the informal sector into the GDP. Different countries around the world have formalised the informal SMEs and this study also shares some of the best practices in different countries like Vietnam, Malaysia, India, etc. The relevant authorities of Bangladesh could take the ideas of successful strategies in the neighbouring countries and take an organised and systematic approach towards formalisation of informal SMEs.

A photograph of a narrow alleyway between brick buildings. A group of women, mostly wearing headscarves and colorful saris, are sitting on the ground, processing long strands of straw or reeds. One woman stands in the background, looking towards the camera. The scene is brightly lit, suggesting daytime.

Chapter 1

Introduction

1.1. Background of the Study

This report is prepared as part of the research conducted on “Informal SMEs in Bangladesh: Formalisation Challenges and Way Forward” funded by SME Foundation and FES Bangladesh.

Small and Medium Enterprises (SMEs) in Bangladesh are the engine of economic growth and development irrespective of the economic status of the country (Dasanayaka, Kankanamge, and Sardana, 2011; Hyz, 2011; Lawrence et al., 2006)

About 90% of businesses and more than 50% of employment around the globe are represented by SMEs. The contribution of formal sector SMEs is up to 40% of GDP in emerging economies, which further increases if informal SMEs are considered (World Bank, 2019). According to the Bangladesh Economic Research report (2018), the informal sector in Bangladesh contributes 23% of the industrial GDP and 80% of the total employment in the private sector. In emerging economies such as Bangladesh, SMEs are labour-intensive and cover those markets usually left by the large firms (Maksimov, Wang, and Luo, 2017). The SME sector is deemed to be more flexible, in terms of strategy development and decision making, in comparison to the large-scale industry (Galli-Debicella, 2021).

SMEs not only contribute to economic development, but also contribute in social network building, ensuring the living standard of poor people, increasing export earnings, creating new entrepreneurs, and satisfying the needs of consumers with competitive prices (Hossain and Ibrahim, 2020). According to the available data, Bangladesh has 7.8 million enterprises that employ 24.5 million people. As per Labour Force Survey 2022 conducted by Bangladesh Bureau of Statistics (BBS), 84.9% of the labour force of Bangladesh is employed in the informal sector contributing to more than 40% of the total GDP.

A large part of the SME units operates informally without any business registration or license, made possible due to the absence of effective business governance and monitoring practices in place (Dallakoti, 2024). According to the Industrial Policy 2022, economic activities such as domestic workers, street vendors, and waste pickers, which are not under any statutory law or not related to revenue mobilisation, or are not registered with appropriate authorities, would be considered as informal sector. Many industrial units do not have documents such as VAT, TIN, trade license registration number, etc. Because of the lack of these documents, these enterprises do not have access to institutional

credit and suffer from networking and technological capabilities. Literature suggests that small entrepreneurs are not interested in being compliant with VAT and TIN-related matters due to several reasons.

Many studies also show that large numbers of informal firms coincide with lower economic development, low productivity and efficiency (Rothenberg et al., 2016; International Labour Organization [ILO], 2018; Deléchat and Medina, 2020). A well-designed national policy framework to formalise informal enterprises is needed to boost productivity and create quality jobs efficiently.

Under such circumstances, the government of Bangladesh has included this large sector in the new Industrial Policy 2022 and decided to create a national informal sector database and also announced an action plan for the formalisation of the sector. The prime motive of this formalisation is to reduce regulatory and tax burdens, expand access to formal financing, improve education and other public services, and strengthen public revenue frameworks. Given the above situations, this report aims to investigate the challenges of formalisations and what can encourage and smoothen the formalisation process.

1.2. Objective

1.2.1. Broad Objective

Based on the Terms of Reference (TOR), proposal, and discussion with SME foundation, the broad objective of this study is to analyse the current scenario of the informal SMEs¹ in Bangladesh, the challenges to formalising the informal SMEs, and the way forward.

1.2.2. Specific Objectives

The specific objectives of the project are:

- To identify the types and characteristics of informal enterprises in Bangladesh;
- To estimate the size and contribution of informal enterprises to the Bangladesh economy;
- To analyse the impact of informal enterprises on poverty reduction and inclusive economic growth in Bangladesh;
- To assess the working conditions and employment practices in informal enterprises;
- To find out the challenges and the way of overcoming those challenges of informal SMEs;

¹The term “informal SMEs”, “informal enterprises”, “small informal enterprises”, “small business owners”, and “small entrepreneurs” are used to refer the small informal business enterprises and used interchangeably in the report.

- To identify the policy gaps and challenges in promoting and regulating informal enterprises in Bangladesh;
- To draw lessons from the neighbouring South Asian Countries and South East Asian countries, namely like India, Pakistan, and Sri Lanka and possibly ASEAN countries (e.g., Malaysia, Singapore, etc.) where interventions and initiatives have been taken to bring the informal SMEs into the mainstream; and
- To provide recommendations on how to formalise the informal SMEs in Bangladesh.

1.3. Scope of Work

Based on the Terms of Reference (TOR) provided by SME Foundation and FES Bangladesh, and also subsequent literature review, the scope of the report is limited to the following:

- The study is focused and limited to those informal small enterprises without any kind of business registration/ trade license;
- The cottage industries were not included in the study; and
- Small enterprises with one employee or more was considered which, by definition, means the micro enterprises are also part of the study.

1.4. Research Methods

The study takes a pragmatic approach and employs a mixed-method approach (Creswell and Clark, 2017). The researchers collect both quantitative and qualitative data to understand the current state of the informal SMEs sector in Bangladesh, their size and contribution, the hurdles they face, the challenges in formalising the informal SMEs, and the way forward.

1.4.1. Research Design: Quantitative

The objective of the quantitative part is to find out the following:

- To investigate the factors that motivate the informal SMEs to become formal; and
- To identify the challenges of the informal SMEs in becoming formal.

Quantitative Data Collection

Researchers applied random sampling (Babbitt et al., 2015) to collect the responses for survey questionnaire. To collect sample data, the study used a questionnaire (Ishengoma, 2018) using both face-to face survey and telephone survey. The format of the questionnaire includes a dichotomous response of "Yes" and "No" for factors motivating informal SMEs to formalise whereas "Five Point Likert Scale " measurement was used to collect the questions regarding challenges of

informal SMEs in becoming formal. Moreover, the questionnaire also includes nominal and continuous responses to capture data of various demographic factors. A total of 327 responses were collected from informal business owners of Bangladesh. To pre-test the questionnaire with few respondents for face validity (Sarstedt and Mooi, 2019), a pilot study of 64 samples was conducted. Finally, data for demographic characteristics, factors motivating informal SME owners to formalise and challenges for them in becoming formal was collected using the software Surveyhiv. A total of 263 respondents were interviewed for the survey based on the data provided in the Business Directory 2019 by BBS, of which 23 samples were excluded as they have already been registered. Finally, the researchers chose a sample size of 304 considering the data from both pilot survey and main survey.

Quantitative Data Analysis

The quantitative data has been analysed using the statistical software IBM SPSS Statistics. Descriptive statistics was used to find out the percentage summary of the factors motivating informal SMEs to become formal. For the diagnostic test, Pearson correlation matrix was used to find out whether the independent variables are correlated with each other, and Cronbach's Alpha score was employed to test the reliability of the survey instrument (Khalil et al., 2022). Survey responses from Five Point Likert Scale were analysed to address the challenges informal SMEs might face in becoming formal. Lastly, researchers applied a logistic regression model to find out the factors which tend to motivate the transformation of informal SMEs into formal SMEs (William and Shahid, 2014; Ishengoma, 2018; Mukorera, 2019). As the dependent variable is motivation to formalise which is in the form of dummy variable, logistic regression model was applied since it has become the standard method for modelling a dichotomous output (Allison, 1999).

1.4.2. Research Design: Qualitative

The objective of the qualitative part is to explore the following:

- The key characteristics and the challenges faced by informal SMEs in Bangladesh;
- The perceptions and attitudes of informal SME owners towards formalisation; and
- The potential barriers and enablers for formalising the informal SMEs in Bangladesh.

Qualitative Data Collection

The researchers collected qualitative data through Focus Group Discussions (FGDs) and Semi Structured Interviews. The researchers conducted 2 FGDs: 1. One with the SME owners (both formal and informal) and 2. One with the policymakers, regulators, government officials, development organisations and donors, etc. The breakdown of the participants of the interviews and FGDs are given in the table below:

Table 1: Qualitative Data Collection

Data Collection	Participants No. Research Instruments and Sampling Technique	Category of Respondents
Focus Group Discussion (FGD)	Random Sampling No. of Participants: 10 Location: Dhaka	Informal and Formal SME Owners (Both male and female)
Focus Group Discussion (FGD)	2 (10 members) (Purposive sampling and Snowballing)	Financial Institutions, Association members, Officials of SME Foundation, Industry Ministry, SME Experts, ILO, Economists, Formal Entrepreneurs, Development Organisation, Research Organisation, etc.
In-Depth Interview(s) (IDIs)	9 (Purposive sampling)	<ul style="list-style-type: none">• SME Owners: 3 IDIs• Business Associations (NASCIB/ Women Chamber): 2 IDIs• Economists and Experts in SMEs: 2 IDIs• ILO: 1 IDI• Policy Advocates: 1

Qualitative Data Analysis

The qualitative data is transcribed and translated, and the researchers have reviewed and analysed the data collected from interviews and focus groups. Qualitative data has been coded and codes are used to identify recurring themes, patterns, and insights. This analysis helped the researchers uncover common challenges, potential solutions, and emerging ideas related to formalising the informal SMEs.

Both qualitative and quantitative data are interpreted, and 2 follow up interviews were conducted to ensure validity of the data. Based on the analysis of both the quantitative and qualitative data, we interpret the

findings, identify the relevant findings and themes that provide meaningful insights into the formalisation process of SMEs, and draw conclusions. While analysing and interpreting the data, careful considerations will be provided to the unique characteristics of the Bangladeshi context and how they influence the strategies and recommendations for formalisation. Based on the findings, the researchers came up with some actionable, practical, and tailored recommendations for the policymakers for the informal SMEs in Bangladesh.

1.5. Limitations

The primary limitation of this study has been the lack of comprehensive and updated database on the informal sector. In fact, the database on formal SMEs are not updated, which potentially hinders the analysis. However, the researchers have collected raw data (unpublished from BBS on the Business Directory of informal enterprises in 2019), with employees more than 10, which was used to analyse the current status of informal SMEs and also as the population for the random sampling used for the survey.

1.6. Expected Contribution

This study enriches the literature on informal SMEs with not only the perceptions and insights of the policymakers, experts, regulators, etc. but also with personal narratives of entrepreneurial activities from the micro level. Therefore, many detailed factors are revealed of the lives and understanding of entrepreneurs and experts, dealing in one way or the other with the informal economy.

This study has several policy implications. The findings and the recommendations will provide insights to the policymakers with data and insights for government intervention on formulating exclusive policies for the formalisation of informal enterprises.



Chapter 2

Informal SMEs in Bangladesh

2.1. Informal Sector and Informal SMEs in Bangladesh

As mentioned before, the National Industrial Policy 2022, which had been published by the Ministries of Industries, Bangladesh on September 29, 2022, defines informal economy to include economic activities, comprising domestic service providers, street sellers, waste pickers, etc., which are not covered under any statutory law or not involved in mobilising revenue or not formally registered with relevant authorities (New Age Business, 2022). However, informal enterprises involved in the trading of illicit goods and services (e.g., drug trafficking, gun-running), are not a part of the informal economy; rather they belong to the broader criminal economy. The table below highlights the scenario of the size of the informal economy in selected countries.

Table 2: Contribution of Informal Economy to GDP

Country	Size of Informal Economy (% of GDP)
Bangladesh	30.20%
Bhutan	22.80%
India	43.10%
Indonesia	22.70%
Pakistan	35.60%
Sri Lanka	31.10%
Malaysia	25.30%
Thailand	46.20%
Vietnam	20.50%
Nepal	33.20%
Myanmar	49.00%
Zimbabwe	64.10%
USA	7.30%
UK	10.30%
Germany	11.20%
France	13.10%

Source: World Economics (2022)

According to International Labour Organization [ILO] (2023), informal enterprises refer to all enterprises doing economic activities by workers and economic units that are not covered or not sufficiently covered by formal arrangements, thereby being unrecognised, unregistered, unprotected, and not regulated under any form of labour regulations and social protection laws. Ullah (2023) gave a similar definition for the informal sector; as like a growing occupational sector for the relatively lower skilled people, generating significant levels of employment.

Any developing nation's informal sector is a crucial part of its economy. For those with less education or experience, this is a rising vocational field that offers significant employment. The phrase "informal sector" was first used in Hart (1973)'s seminal article, which asserted that this sector offers a variety of labour-intensive, low-cost, competitive goods and services. Kabra (1995) listed thirty phrases as synonyms for the unorganised sector, such as transitional activities, the survival sector, and the non-structured sector. Various writers use terms such as "non-formal sector" (ILO-SAAT and UNDP, 1998), "urban subsistence sector" (Cole and Sanders, 1985), "non-westernized sector" (Hackenberg, 1980), and "lower-circuit of urban economy" (Santos, 1979) to define the informal sector. According to an ILO report (ILO, 2018), 93% of the world's informal employment lies in emerging and developing nations, where informality exists for both own-account workers and when hired by employers (in the form of temporary or casual workers, seasonal workers, etc.). In most developing nations, the idea of the informal sector has been used to analyse the employment situation in relation to policy possibilities.

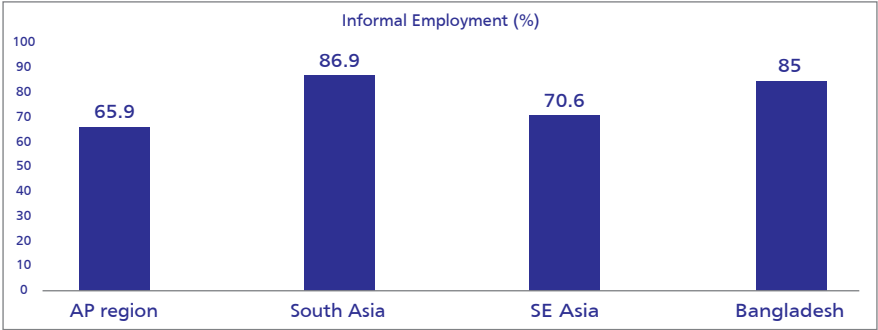


Figure 1: Contribution of Informal Sector to Employment
Source: ILO (2018), Men and Women in the informal Economy

Studies and some international organisations have confirmed the significant empowerment role of the informal sector both in developed and emerging economies (Nasution, 2019; Dell'Anno, 2021). ILO (2018) estimates indicated that the informal economy represents 65.9% of total employment in Asian and Pacific countries, 86.9% in South Asian countries, and 70.6% in Southeast Asian countries. According to ILO, approximately 85% of the labour force of Bangladesh is employed in the informal sector and they provide a safety net for many households that would otherwise be in unemployed or poverty situations.

The Labour Force Survey 2022 by BBS surveyed the labour force status of Bangladesh both from formal and informal sector. Out of total, informal employment is more than 59 million people in Bangladesh,

where 24 million informal employees are female and more than 35 million are male. Division wise, most of the informal employment (more than 16 million employment) has been accounted for by the Dhaka Division and the lowest being 3 million employees in Barishal division.

Table 3: Informal Employment Status of Bangladesh (in million)

	Total Employment	Female Employment	Male Employment
Dhaka	16	6	10
Barishal	3	1	2
Chattogram	10	4	6
Khulna	7	3	4
Rangpur	8	3	4
Rajshahi	8	3	5
Sylhet	4	1	2
Mymensingh	4	1	3
Bangladesh	60	24	36

Source: Labour Force Survey 2022 by BBS and compiled by authors

Table 4: Male-Female Informal Employment Ratio in Bangladesh

	Total Employment Ratio	Female Employment Ratio	Male Employment Ratio
Dhaka	84.50%	96.30%	78.30%
Barishal	78.20%	95.20%	70.00%
Chattogram	84.00%	97.10%	76.20%
Khulna	84.50%	95.30%	78.60%
Rangpur	85.00%	96.50%	78.20%
Rajshahi	86.60%	97.50%	80.40%
Sylhet	91.00%	98.70%	86.30%
Mymensingh	85.50%	96.70%	80.90%
Bangladesh	84.90%	96.60%	78.40%

Source: Labour Force Survey 2022 by BBS and compiled by authors

From Table 4, we can see, country level informal employment is 84.90%. Sylhet division has the highest informal employment (91%) followed by Rajshahi division (86.60%) and the lowest informal employment is in the Barishal division with the ratio of 78.20%. The highest informal female employment ratio is from Sylhet division at 98.70% whereas, for informal male employment ratio, it is 86.30% also from the Sylhet Division.

2.2. Characteristics of Informal Sector and Informal SMEs

Informal sector is mostly labour intensive (Ohnsorge and Yu, 2022) and is devoid of any formally regulated supervision (Phillip, 2017). A summary of the characteristics present in the informal sector (IS) is tabulated below:

Table 5: Characteristics of the Informal Sector

People engaged in IS	Activities in IS	Land and Housing in IS
Absence of official protection and recognition	Unregulated and competitive market	Unauthorised use of vacant public or private land
Non coverage by minimum wage legislation and social security system	Reliance of locally available resources	Illegal subdivision or rental of land
Absence of trade union	Labour intensive and adapted technology	Unauthorised construction of tructures and buildings
Low income and wages	Absence of institutional credit or other supports and protection	
Little / No job security	Ease of entry	

Source: Ullah (2023)

The major characteristics of the informal SMEs in Bangladesh are similar to above and to those in the other developing countries and include: (i) unregistered, small scale operation; (ii) low level of productivity; (iii) low level of income generation; (iv) low level of institutional credit access (sometimes lack of access to formal credit); (v) employment based mainly on kinship, personal/social relations, and casual employment but mostly not on a contract basis; and (vi) generally the absence of recognition or regulation by the government (Raihan, 2010). Hossain, Siddique, and Islam (2015) discovered some common occupations across the informal economy, which consisted of clothing, foods, fashion products, fruits, household items, stationary, medical services, and electronics.

Yeasin (2022) characterised the informal SME of Bangladesh to have unrecognised and unrecorded small-scale activities that have low productivity and generate lower income; with little to no access to institutional and financial services like infrastructural support and credit facilities; and an absence of contractual based work structure. The neighbouring country India’s National Commission for Enterprises in the Unorganised Sector (NCEUS) has outlined the informal sector to contain

all private enterprises that are yet to be incorporated and are owned by entities in a proprietorship or partnership basis with a maximum of 10 workers (Federation of Indian Chambers of Commerce and Industry, 2017).

2.3. Differences between the Formal and Informal Sector

There are certain characteristics of the formal and informal sectors of the country which help to distinguish them. These are tabulated below:

Table 6: Differences between the Formal and Informal Sectors of Bangladesh

Formal Sector	Informal Sector
People work for wages in government, or private sector firms, or where they own such firms	People make ends meet by earning money or producing goods for their own consumption, often without formal employment or conventional 'jobs'.
They pay income taxes and where firms pay value-added tax	They do not pay income taxes and do not collect value-added tax on what they sell
What they produce is counted in national production (GDP)	What they produce is not counted in national production
They are counted in the workforce	not counted in the workforce
Their time is usually fixed according to the labour law	Their time is usually unstructured: 'I work whenever I can', 'I work as long as it takes'
They have legal protection and right	They are without rights and protection
High barriers to entry	Low barriers to entry
Imported technology	Adapted technology
Capital intensive	Labour intensive
Protective market	Unregulated competitive market
Greater intereconnectedness with global markets	Greater connectedness with local markets

Source: Ullah (2023)

From the table above, it can be understood that the informal sector has comparatively lower barriers to enter due to the lack of a regulatory environment and use of traditional and labour-intensive inputs whereas the formal sector is more difficult to penetrate as it is highly regulated and is capital intensive through the use of advanced technology. However, there is a linkage between these two sectors, which can be explained by the next diagram:

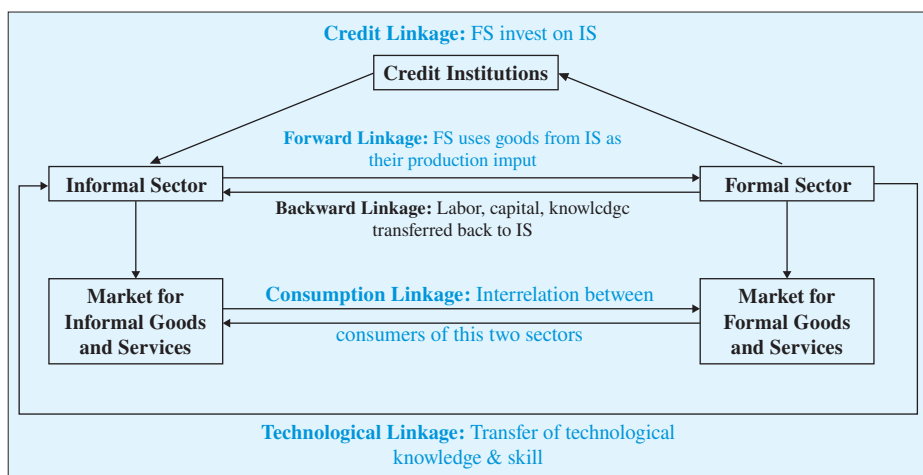


Figure 2: Linkages between the Formal and Informal Sectors of Bangladesh

Source: Ullah (2023)

2.4. Current Institutional Context

Due to the multidimensional aspect of the SME sector, there are several institutions and governing entities that are responsible for managing this sector, in terms of policy formulation and advocacy, research support, skill development, access to finance, etc. These are illustrated below:

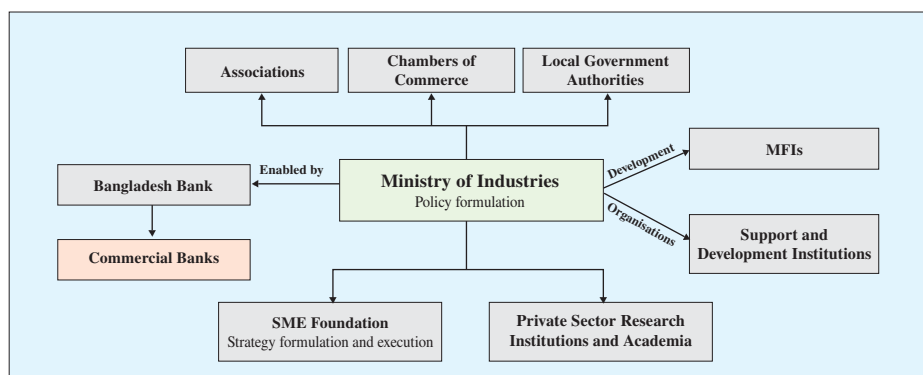


Figure 3: Roles of the Relevant Institutions related to the Informal Sector in Bangladesh

Source: Prepared by Authors

Ministry of Industries (Moi)

In Bangladesh, the Ministry of Industries is crucial in shaping up the industrial landscape and promoting the nation's economic development. It is in charge of formulating and executing laws and rules that govern industrial activities, including those within the SME sector,

such as SME Policy 2019, National Industrial Policy 2022, etc. The ministry's programs are designed to boost investment, advance industrialization, and improve the general competitiveness of enterprises. This entails making financing more accessible, encouraging entrepreneurship, and offering rewards for the advancement of industry, all of which help to create a conducive environment for the country's industrial growth (Ministry of Industries, n.d.).

SME Foundation (SMEF)

The SME Foundation (SMEF) plays a variety of roles in promoting the expansion of the SME industry. It ensures that the action plans and strategic goals specified in the SME Policy 2019 are implemented thoroughly. SMEF fosters an environment that accelerates the development of SMEs by working with organizations such as Bangladesh Bank and the Bangladesh Investment Development Authority (BIDA). It also develops successful plans to support the expansion of SMEs and specializes in sector-specific interventions by evaluating the current scenario and conducting various research. Additionally, the organization encourages excellence by fostering competition among SMEs through the SME Awards program.

Bangladesh Bank

Bangladesh Bank and other commercial banks are essential to the development of SMEs, when it comes to access to finance, credit facilities, refinancing schemes, involving commercial and SME banks to empowering creating SME clusters. They enable women entrepreneurs to enter the business world by offering them single-digit interest rate loans without collateral. In addition, they present plans and initiatives designed to support and grow SME businesses, design and provide stimulus packages during crisis, design refinancing schemes advancing the nation's economic growth and employment opportunities. Bangladesh Bank's financial support and efforts, carried out by the commercial banks, play a crucial role in enabling the expansion of small and medium-sized enterprises and bolstering economic inclusion in Bangladesh (Bangladesh Bank, n.d.).

Associations and Trade Bodies

There are a number of business associations and trade to facilitate SME development. They arrange regional and national SME product fairs, providing SMEs with vital visibility and expansion prospects. They offer comprehensive training facilities in a variety of subjects, including marketing, product manufacturing, company management, entrepreneurial leadership, and vocational skills. They consistently

engage in discourse with the government to impact policy formulation, thereby making a substantial contribution to the country's economy. In addition, they facilitate business registration, simplify business operations, and offer entrepreneurs loans and training facilities, all with the overall goal of reducing poverty, creating jobs, and supporting creative small and cottage enterprises.

Chambers of Commerce

The Chambers of Commerce in Bangladesh, such as Federation of Bangladesh Chambers of Commerce and Industry (FBCCI) and Dhaka Chamber of Commerce and Industry (DCCI), have pivotal roles behind the growth of SMEs in Bangladesh. Their proactive participation includes assisting the Ministry of Industries by supplying facilities and essential resources that enable the expansion of SMEs. Additionally, they carry out strategic projects meant to strengthen the capabilities of Women Chambers and other trade associations, providing them with the resources and expertise needed to provide crucial leadership and support for SMEs.

Local Government Authorities

Local government authorities at the municipal and city levels like union parishads, Pouroshova are responsible for the business registration procedures, reducing administrative obstacles and facilitating the establishment of SMEs. Additionally, they make investments in the development of infrastructure, such as utilities and transportation, which are essential for SME operations and market access. These authorities cooperate with vocational training institutions to improve the skills of the local workforce. At times, these authorities provide funding or subsidies in order to encourage the expansion of SMEs and create jobs.

Micro Finance Institutions (MFI)

With an emphasis on women entrepreneurs in particular, the MFIs provide a range of financial and technical support programs designed to strengthen the capability and expansion of informal SMEs. In order to facilitate business expansion and asset acquisition, they offer interest-free loans, comprehensive banking solutions, and credit facilities to satisfy the specific financial needs of SMEs. They also provide technical assistance and financing support to a variety of industries, which promotes rural development and job creation.

Support and Development Institutions

Support and development institutions, both local and international, contribute significantly to the advancement of SMEs. They support fair job opportunities, foster supportive financial environments, lend money to SMEs to improve their access to credit facilities, and carry out comprehensive research on SMEs. Institutions such as International Labour Organization (ILO), Friedrich Ebert Stiftung (FES), and Asian Development Bank (ADB) are also responsible for generating dialogues between relevant stakeholders in the industry and coming up with policy formulations pertaining to the development and growth of SMEs.

Private Sector Research Institutions and Academia

Industry-academia collaboration is a fundamental element required in the development of the SME sector. The educational and private sector research institutions, such as Centre for Policy Dialogue (CPD), South Asian Network on Economic Modeling (SANEM), Bangladesh Institute of Development Studies (BIDS), etc., stimulate innovation via research, and enable the useful use of knowledge and technology. These institutions support businesses by engaging in policy discussions and imparting vocational skills to workers to improve the workforce. They all work together to ensure the alignment of skills demanded by the industry and skills supplied by the institutions.

There are definitely other governing bodies and institutions that facilitate in the operations of the SME sector of the country. While making an exhaustive list is not possible due to the intricacies of the operations, the above section has tried to delve into the major important stakeholders who play the contributory roles in this sector.

2.5. Policy Gaps in the Current Policy Making Framework

Policy making is an integral part of any nation's development because it guides a nation on the particular course of action to take in order to achieve its future goals and aspirations (Aziz, 2006; Sayem, 2020). Policy can be developed by many groups such as the government, private sector, social groups, NGOs, etc. Dye (1981) defined public policy as anything that governments decide to do or not to do. It therefore implies that not taking any action is also a part of policy making because government inaction can have an equal impact on the public and the economy as government action. Two distinguished authors, Hogwood and Gunn (1984), had shed light on the multidimensional aspect of policy by interpreting policy as:

“A label for a field of activity initiated by the government or a legitimate authority; as an expression of a general purpose or desired state of affairs; as specific decisions of government; as a particular set of activities having authorisation, parliamentary approval, or statutory endorsement; as a programme involving particular packages of legislation and organisation efforts.”

They have emphasised the contributory role of any governing entity that has a legitimate authority in formulating policies.

Despite playing such an important part in the development of a nation, there is currently a huge gap in the policy making process, with respect to the informal sector of Bangladesh. These are explained below:

- 1. Lack of a Unified Definition:** There is no official definition as to which enterprises fall under the informal sector. Although the demarcation of cottage, micro, small, and medium enterprises has been done in terms of the number of employees and revenue generated in the SME Policy 2019, there is no proper way to identify the enterprises that fall under the formal or informal categories. Literature has defined informal enterprises as having multiple characteristics such as being labour intensive, relying on traditional inputs, not having any legal or social protection rights, operating in unregulated markets, etc. As per ILO, the informal economy refers to all economic activities by workers and economic units that are– in law or in practice– not covered or insufficiently covered by formal arrangements. It thrives mostly in a context of high unemployment, underemployment, poverty, gender inequality and precarious work. The situation is aggravated in conflict-affected and fragile situations where there is no other alternative than operating in the informal economy for securing livelihoods.² ILO defines informality in terms of informal enterprises and informal employment. Informal employment refers to the working arrangements that are in practice or by law not subject to national labour legislation, income taxation, or entitlement to social protection or other employment guarantees; for example, advance notice of dismissal, severance pay, or paid annual or sick leave.³

² <https://www.ilo.org/projects-and-partnerships/projects/partnership-improving-prospects-forcibly-displaced-persons-and-host/themes/informaleconomy#:~:text=he%20informal%20economy%20refers%20to,gender%20inequality%20and%20precarious%20work>

³ <https://www.google.com/url?sa=t&source=web&rct=j&opi=89978449&url=https://www.ilo.org/media/5481/download%23~:text=3D%20ILO%2520brief,paid%2520annual%2520or%2520sick%2520leave.&ved=2ahUKEwj7ilr4-OIAxXk0KACHe-WOHgQFnoECBwQBQ&usq=AOvVaw23lo2UfPIz2042Utlpxwd>

However, each country's context will vary depending on its social and political environment. In that aspect, there is an absence of indicators that are applicable in the Bangladeshi context to effectively differentiate the informal businesses from the formal ones. As a result, each governing body interprets informal enterprises in their own way and the presence of inconsistency in the definition implies that no single treatment can be applied to all of them, thereby leading to confusion and loss of efficiency in utilising the resources of the informal enterprises. Another problem is that there are many different ways of business categorisation. For instance, SME stands for small and medium enterprises whereas MSME stands for micro, small, and medium enterprises and again CSME refers to cottage, small, and medium enterprises. Often, the challenges faced by the small enterprises are far more detrimental and serious than that of the medium enterprises. There is an additional lack of clarity as to whether the small of SMEs include cottage and micro enterprises or not which make it more difficult to comprehend and manage the informal economy.

2. **Low Visibility in the Industrial Policy 2022:** Until 2021, there was no mention of the informal sector in the Bangladesh Industrial Policy and has not been an agenda of prioritization for the relevant governing bodies. Industrialisation is required for any nation that wants to have a sustainable development plan in place, which is why it is important to include agendas in the Industrial Policy which needs major attention and development at the government level. However, the absence of the informal sector from the Industrial Policy for so long meant that there was no proper focus on this sector by the nation and thus no course of action was designed to manage the complexities associated with it. In 2022, merely a chapter (Chapter-4) has been dedicated to the informal sector and its development plan through database creation, training support, financial access, etc. There is still a long way to go because the enhancement of the informal sector is a long-term plan.
3. **Lack of Representation in the SME Policy 2019:** The informal sector has very little representation in the SME policy of the country. This is a policy developed to ensure that a vibrant SME sector can be created which can add to the GDP and productivity of the economy. Although much of the employment comes from the informal sector, there are no rules or regulations that are specific to the informal sector. The most that has been stated is to

simplify the registration process to enable smooth transition of enterprises from informal to formal. However, exactly why informal enterprises should turn to formal is something that is not explicitly mentioned in the policy. Many facilities and benefits of being formal are stated but the lack of emphasis on the informal sector again highlighted the lack of attention of the nation on its major employment-generating sector. This has eventually resulted in the inefficient management of the informal economy which has often led to cases of tax evasions, unfriendly working environment, fear of uncertainty, etc. among the informal sector workers. This has hampered the growth and existence of these enterprises.

4. Absence of Integrated Policy Framework by Regulatory Bodies:

Finally, many institutions have tried to help the informal sector from their respective ends. For instance, Bangladesh Bank has introduced credit wholesaling programs, collateral-free loans, etc. but due to the negative connotation that commercial banks have attached to the informal sector workers, in terms of loan repayments, as well as the loan clauses that banks have set, these workers do not get access to the loans. Therefore, a conflict or a clash arises during the implementation of such actions. NASCIB and SME Foundation have tried to start help desks to facilitate information and resource support for the informal business owners. However, there is still some sort of fear of uneasiness working in those owners for which they do not feel comfortable in going to the help desks to ask for support. No proper training has been given to the enterprise owners for which they are not aware of the help desks and have not been able to disclose their problems without any hesitation. The main problem lies in the fact that although many regulatory entities have tried to come up with their own set of initiatives, it will not be helpful for the informal community, as a whole, as long as there is no integrated effort from the institutions under the supervision of the government.

2.6. Current Scenario of the Informal SMEs in Bangladesh

According to the Business Directory 2019 by BBS, total informal businesses in Bangladesh are 7,023 with minimum employment of 10.⁴ BBS has conducted a population study in 2019 for SME (both formal and

⁴As part of data collection, the researchers collected the raw population data on business directory 2019 from BBS and analysed the data. The descriptive statistics provided in this chapter are authors' calculations and analysis based on the data provided by BBS. The small enterprises with less than 10 employees were not included in the Business Directory 2019 and thus not considered in this analysis.

informal). Though the data was not published, the researchers collected and analysed it. Table 7 and Figure 4 present the status of countrywide informal businesses in Bangladesh. 36% of informal businesses from the directory are situated in Rajshahi Division, followed by Dhaka Division and Rangpur Division, with 23% and 15% of informal businesses, respectively. Barishal Division has the lowest number, with 2% of informal businesses. According to Parvez (2014), two Northwest divisions, Rajshahi and Rangpur, experienced a rising number of economic units and households that included non-agricultural economic activities such as shops or workshops. One of the possible reasons for the presence of the highest number of informal businesses in Northwest divisions is the construction of the Jamuna Multi-purpose Bridge that has created a transportation link between Dhaka and these two divisions.

Table 7: Status of Informal Businesses in Bangladesh

	Dhaka	Barishal	Chattogram	Khulna	Rangpur	Rajshahi	Sylhet	Mymensingh	Bangladesh
Informal Businesses	1,603 (23%)	155 (2%)	618 (9%)	211 (3%)	1,067 (15%)	2,506 (36%)	544 (8%)	319 (5%)	7,023 (100%)

Source: Business Directory 2019 by BBS and compiled by authors

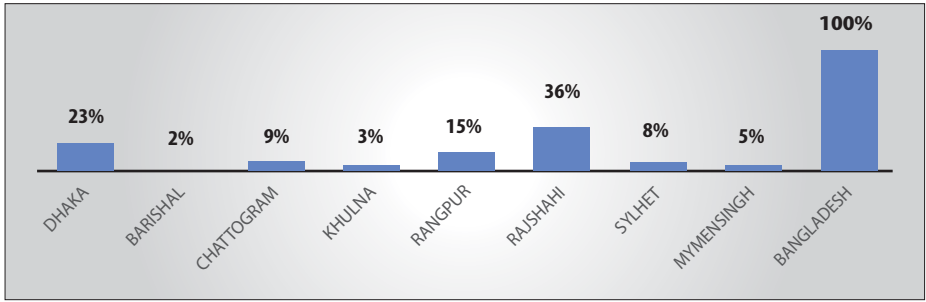


Figure 4: Status of Informal Businesses in Bangladesh

In Table 8, according to the enterprise surveys of World Bank in 2022, the informal enterprises in Dhaka Metropolitan and Cox’s Bazar are mostly retail oriented with scores of 85.40% and 86.30% respectively, whereas in Chittagong MA, the informal sector mostly comprised of service-oriented businesses.

Table 8: Informal Business in Bangladesh based on Industry Type

Informal Business Sector (%)				
Area	All Business	Manufacturing	Retail	Other Services
Dhaka MA	83.80%	69.40%	85.40%	80.60%
Chittagong MA	73%	76.20%	71.10%	79.20%
Cox's Bazar	65.20%	28.50%	86.30%	74.70%

Source: World Bank Enterprise Surveys of Informal Businesses 2022

Table 9 presents the scenario of informal businesses in Bangladesh based on the types of sectors. The statistics show that the education sector has the most informal businesses, followed by the manufacturing sector. From a division-wise perspective, maximum educational institutions are in the Dhaka division, and manufacturing firms are in the Rajshahi division. Among this manufacturing sector, the highest cluster in this division is the weaving of textiles (excluding handloom), as presented in Table 10. Dhaka Division has ranked second in terms of the manufacturing sector, but individually, the Pre-Primary and Primary education clusters dominate the informal businesses in the larger Dhaka Division (Table 10). Another aspect that we can see in Table 8 is that, out of 8 divisions, the informal education sector is the highest cluster in six divisions. This phenomenon is primarily due to the presence of many unregistered Quomi madrasas. Necessary actions can be taken by concerned authorities to bring them into the formal sector and help increase the quality of education.

Table 9: Industry wide and Division wise Informal Enterprises in Bangladesh

	Dhaka	Barishal	Chattogram	Khulna	Rangpur	Rajshahi	Sylhet	Mymensingh	Bangladesh
Electricity, gas, steam and Air conditioning Supply	7	1	4	0	9	9	5	1	36
Water Supply; Sewerage; Waste Management and remediation activities	1	0	2	0	0	1	0	0	4
Construction	2	0	5	0	4	1	3	1	16
Wholesale and retail trade; repair of motor vehicles and motorcycles	22	1	10	11	2	4	1	2	53
Transportation and storage including postal and courier	9	2	1	4	7	3	1	1	28
Accommodation and food services activities	28	2	14	1	5	5	3	2	60
Information and Communication	6	1	2	1	3	1	0	1	15
Financial and Insurance Activities	11	2	6	5	10	8	30	2	74
Professional, scientific and technical activities	3	0	4	4	2	1	0	0	14
Administrative and Support Service Activities	16	0	4	6	9	3	7	1	46
Public administration and defence; compulsory social security	285	50	87	19	338	107	66	8	960
Education	779	57	373	79	599	284	369	282	2,822
Human health and social work activities	71	16	35	22	45	38	26	7	260
Other service activities	6	0	1	0	0	7	0	0	14
Total	1,603	155	618	211	1,067	2,506	544	319	7,023

Source: Business Directory 2019 by BBS and compiled by the authors

Table 10: Division wise Highest Cluster

Division	Highest Concentration of Cluster	Number
Dhaka	Pre-primary and primary education	347
Barishal	General public administration activities	33
Chattogram	Pre-primary and primary education	125
Khulna	Pre-primary and primary education	27
Rangpur	General secondary education	301
Rajshahi	Weaving of textile (excluding handloom)	999
Sylhet	General secondary education	149
Mymensingh	Pre-primary and primary education	144

Source: Business Directory 2019 by BBS and compiled by authors

The Business Directory 2019 surveyed labour force status of Bangladesh both from the formal and informal sector. Table 11 and Figure 5 show the employment status of informal businesses in Bangladesh and in Table 12 and Figure 6, male-female employment ratio of informal business in Bangladesh is presented where the ratios are calculated by taking the number of total employments in the informal business sector of Bangladesh as denominator. It can be seen that out of total employment of 162,946 people in Bangladesh, only 24.60% (permanent and temporary) employees are female with just 29,800 (18.3%) of them as permanent. Though women are contributing equally like their male counterparts, there is work not much recognized or they are not being hired frequently which is clearly visible from the statistics of tables 11 and 12. Division wise, most of the informal sector employment has been accounted for by the Rajshahi Division. From Table 12 and Figure 6, we can see, most permanent male employment is from Rajshahi division with a ratio of 18.40%, while Dhaka division has the highest number of female employees with a ratio of 5.40%.

Table 11: Employment Status of Informal Businesses in Bangladesh

	Total Employment	Female Employment	Male Employment	Temporary Female Employment	Temporary Male Employment
Dhaka	34,934	8,818	19,479	1,727	3,629
Barishal	4,072	590	2,422	221	839
Chattogram	18,337	3,026	10,970	804	3,535
Khulna	4,987	746	2,244	713	1,171
Rangpur	30,377	5,473	17,423	1,712	5,256
Rajshahi	53,487	8,172	29,919	3,879	11,586
Sylhet	10,607	1,656	7,089	273	1,542
Mymensingh	6,145	1,319	2,178	1,023	1,622
Bangladesh	162,946	29,800	91,724	10,262	29,180

Source: Business Directory 2019 by BBS and compiled by authors

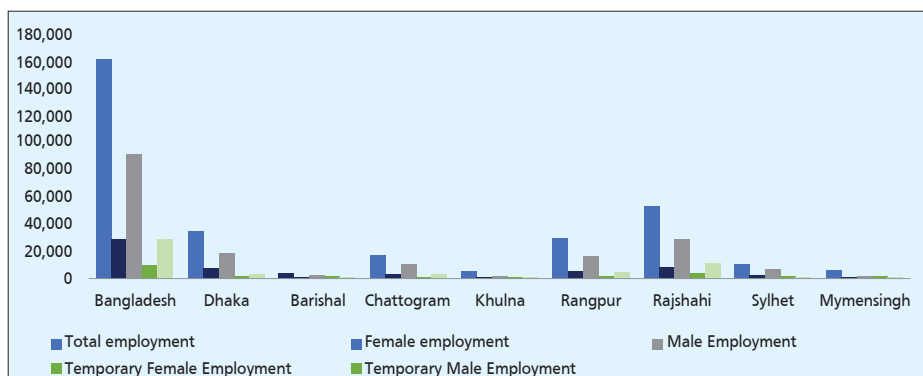


Figure 5: Employment Status of Informal Business in Bangladesh

Table 12: Male-Female Employment Ratio of Informal Business in Bangladesh

	Female Employment Ratio	Male Employment Ratio	Temporary Female Ratio	Temporary Male Ratio
Dhaka	0.054	0.120	0.011	0.022
Barishal	0.004	0.015	0.001	0.005
Chattogram	0.019	0.067	0.005	0.022
Khulna	0.005	0.014	0.004	0.007
Rangpur	0.034	0.107	0.011	0.032
Rajshahi	0.050	0.184	0.024	0.071
Sylhet	0.010	0.044	0.002	0.009
Mymensingh	0.008	0.013	0.006	0.010
Bangladesh	0.183	0.563	0.063	0.179

Source: Business Directory 2019 by BBS and compiled by authors

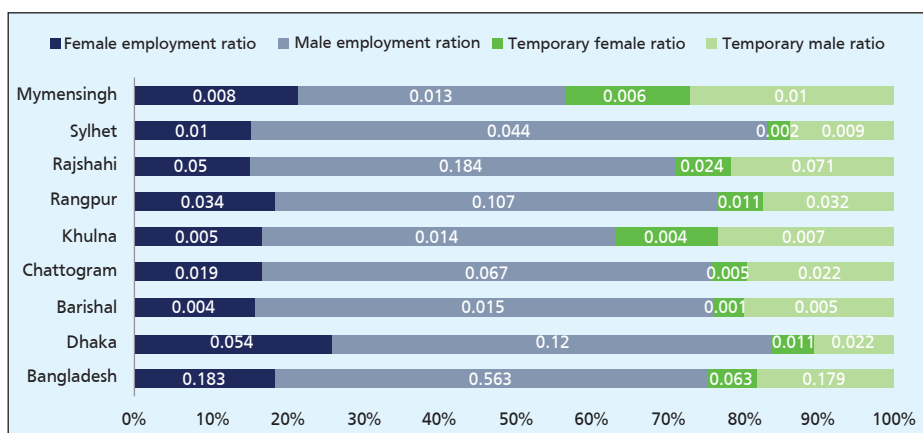


Figure 6: Male-Female Employment Ratio of Informal Businesses in Bangladesh

Descriptive Statistics of Employment of Informal Sector

Tables 13 and 14 provide the summary of the descriptive statistics of employment status of informal businesses in Bangladesh. A brief description of the statistics in Table 13 shows that the average number of employees is 23 with a range of 10 to 2,000. Looking at Table 14, the highest number of informal business employees (2,000 employees) falls under the Construction of roads and railways sector of Rangpur division, and they belong to the category of temporary workers. In Table 13, the average number of permanent female employees is 4 whereas for male, it is 13, indicating a great disparity between male and female employment scenario. The mean of temporary female and male employees are 1 and 4 employees per business with a standard deviation of 10 and 25 respectively. Looking at Table 14, Chattogram division has the highest mean employee with an average number of 30 employees per enterprise. On the contrary, Rangpur Division has the highest diversion of employment from the average number of employees measured by standard deviation of 79.35.

Table 13: Descriptive Statistics of Employment Status of Informal Business in Bangladesh

	N	Minimum	Maximum	Mean	Median	Std. Deviation
Total Female Employees	29,800	-	350	4	2	10
Total Male Employees	91,724	-	1,012	13	9	32
Temporary Female Employees	10,262	-	500	1	-	10
Temporary Male Employees	29,180	-	1,500	4	-	25
Total Employees	162,946	10	2,000	23	14	53.85038

Table 14: Descriptive Statistics of Division wise Total Employment Status of Informal Business in Bangladesh

	N	Minimum	Maximum	Mean	Median	Std. Deviation
Dhaka	34,934	10	1,014	22	13	45.5517
Barishal	4,072	10	266	26	18	31.0229
Chattogram	18,337	10	793	30	15	55.2492
Khulna	4,987	10	504	24	12	51.7377
Rangpur	30,377	10	2,000	28	17	79.3479
Rajshahi	53,487	10	1,435	21	13	50.8195
Sylhet	10,607	10	446	19	14	24.3882
Mymensingh	6,145	10	910	19	13	51.9964

Note: Mean numbers are rounded to the nearest whole number

2.7. Employment Practices and Working Conditions of Informal SMEs

The informal economy of Bangladesh is known to be heterogeneous in nature due to the presence of different types of business enterprises (Raihan, 2021). The lack of a proper definition means that diversified businesses fall under this sector which have varying working conditions and characteristics. The term "informal work" can refer to a broad range of occupations, ranging from simple subsistence labour to intricate and detailed craft work requiring a high level of expertise (Mujeri, 2020a). However, one common aspect of informality is that the enterprises do not fall under any kind of law or framework at the national level which indicates that the informal employees are not protected by labour laws or social rights. There is also no employment contract available for these workers, denying them the fundamental principles and rights at work along with low wage, long working hours, unfavourable working conditions, and little to no growth opportunities.

The defining working conditions that are evident in the informal SMEs in Bangladesh can be illustrated with the figure given on the next page.

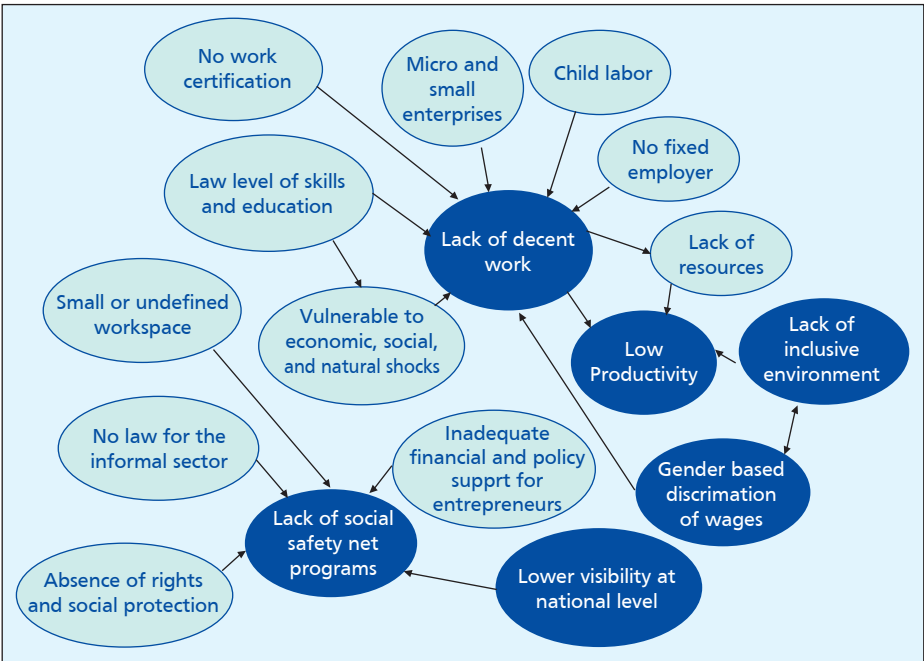


Figure 7: Working Condition of the Informal SMEs in Bangladesh

Source: Ullah (2023)

There is primarily a lack of decent workers in the micro and small enterprises of the informal sector of Bangladesh (Saha and Veen, 2019). They do not have the necessary skills or technological know-how to accomplish the tasks in an efficient manner which reduces their productivity and quality of work.

As the sector does not fall under any regulation of the government, there are no specific work standards or need for compliance. Even the Bangladesh Labour Act does not apply to the informal sector which paves the way for child labour who are working under hazardous conditions (Bureau of International Labour Affairs, 2022). The informal sector workers are not covered under any kind of social safety net programs and unfair and inequitable distribution of income is quite prevalent between men and women. The lack of official status also indicates that the experience gained by working in this sector does not lead to any credible certification (Lange, Baier-D'Orazio, and Hermanns, 2015).

In most cases, there is no specific workplace for the informal enterprises along with changing working hours because the workers are hired on an ad-hoc basis. The lack of proper structure makes them vulnerable to natural disasters like floods and the recent COVID-19 pandemic (Sharif, 2021). Generally, there is a negative connotation attached with these people in terms of repaying back loans which is why they do not get the necessary financial access and support from banking institutions that are needed for their growth and development (Sakib, 2022).

The problems mentioned above combine together to make the contribution from the informal sector seem invisible and not important to the overall development of the country's economy. Even though the sector comprises almost 85% of Bangladesh's labour force as per ILO, it is not getting the equivalent focus and importance in terms of getting structured policy level support from the government and the relevant authorities and associations.

In terms of employment practice, there are different types of employees in the informal SME sectors (Bangladesh Bureau of Statistics [BBS], 2023), such as:

- Own-account workers (self-employed with no employees) in their own informal sector enterprises;
- Employers (self-employed with employees) in their own informal sector enterprises;
- Contributing family workers, irrespective of type of enterprise;

- Members of informal producers’ cooperatives (not established as legal bodies);
- Employees holding informal jobs (i.e. jobs that are not subject to national labour legislation, income taxation, social protection or entitlement to certain employment benefits like paid annual or sick leave, etc.); and
- Own-account workers engaged in the production of goods exclusively for the own final use by their household.

A summary of the types of employees in the informal sector can be illustrated below:

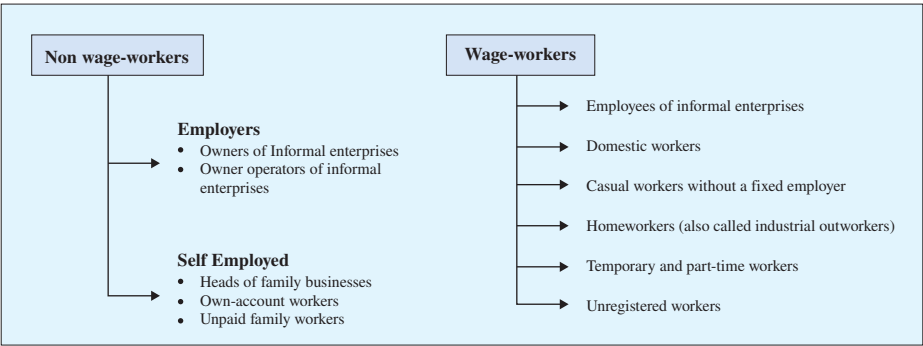


Figure 8: Types of Employees in the Informal SMEs in Bangladesh

Source: Ullah (2023)

As per the Labour Force Survey (LFS) 2022, out of the 59.8 million people involved in informal employment, 38.2% were in the 15-29 years age group whereas the majority (57.8%) was in the 30-64 years age group. The survey also highlighted that formal employment increases with higher educational attainment. This implies that informal sector employees can be associated with lower educational levels and that they do not have the opportunity to gain the necessary skills and knowledge to efficiently run a business. Informal workers have little to no bargaining power because they cannot form unions and therefore are unable to receive any sort of advantages from them (Zahir and Ali, 2020), with regard to obtaining fair wages from the employers. The lower level of education means that the jobs that are included in the informal SME sector do not require sophisticated skills resulting in the creation of very basic outputs.

The most vulnerable and marginalised populations are likely to wind up in the informal economy because of the feminisation of poverty and prejudice towards people based on their gender, age, ethnicity, or disability (Mujeri, 2020). When measured against the total labour

employed, there is a higher presence of women (96.6%) in the informal sector compared to men (78.4%) (BBS, 2023). Women are faced with a greater degree of discrimination, in terms of minimum wage level and unfavourable working conditions. This economic insecurity is often characterised by the lack of regularity in income, pricing and negotiation skills, high-income clientele, and unprincipled or immoral employers.

A large portion of the informal SME enterprises are transient in nature (Mujeri, 2020), meaning that they are built upon temporary structures which can be displaced easily at almost no cost, unlike formal enterprises with established brick and mortar set ups. Although this might be convenient for informal workers when they have to wrap up their shops due to legal force, the poor infrastructure acts as a great barrier for them at times of natural disasters. For instance, during elongated periods of flood, many shops are destroyed or go under waters and become inaccessible to use, thereby cutting off the source of income for a lot of informal enterprise owners. COVID-19 has also forced a number of subsistence shops to close down as a result of declining sales and prolonged period of lockdown (Bhuiyan, 2020).

The banking policies and documentation requirements, in case of obtaining loans and institutional credit, act as a great hindrance for the informal SMEs. Often, they are asked for collateral against the loans which they are not able to provide. Also, due to the social stigma attached with informal enterprises of not being able to repay loans, mainstream banks do not favourably view them. For instance, the government of Bangladesh had announced \$2.3 billion meant for the CSME sector to help them recover after COVID-19 (Sakib, 2022). However, the financial institutions did not move forward with these loans for which the enterprises had to suffer greatly and many even had to close down their shops permanently. Consequently, some of these enterprises seek help within their known circle of people or from microfinance institutions where the interest rate is extremely high. The lack of financial literacy and business acumen of the enterprise owners significantly limit their demand to avail loans and their subsequent motivation to gain more information on this.

2.8. Impact of Informal SMEs on Economic Development of Bangladesh

The contribution of SMEs has been considered fundamental for achieving long-term development through a nation's industrialisation. The manufacturing sector's contribution to GDP, which comprises small, medium, and cottage businesses, increased Labour Force Survey 2016-17

from 23.36% in FY21 to 24.45% in FY22, according to BBS (Begum et al., 2022). Informal labour has a higher return in the agriculture sector as compared to the industrial and services sector where formal labour has proven to be more efficient (Asian Development Bank, 2012). As per ILO estimates, the informal sector is responsible for almost 87% of the nation's employment (International Labour Organization, 2019) therefore it is a great source of poverty alleviation for the country. However, because the enterprises of this sector do not have any legal obligation to provide tax, the government is missing out on a significant amount of revenue that could have been generated from their taxes. This signifies that greater the extent of informal employment, higher the potential loss in tax revenue for the country. In fact, the tax-to-GDP ratio of Bangladesh is 7.5% which is the lowest in the world (TBS Report, 2022), which would have been a lot more if the informal sector could be formalised.

Also, despite generating most of the employment, the quality of outputs produced by this sector is not up to the mark and is not competitive enough, compared to the global standards. This is due to the fact that the lack of creative, technical, managerial, and technological skills, coupled with the limitation of resources, restrict the informal enterprise workers to expand their business and bring in new innovations to improve their products. Thus, the informal sector remains a low-income sector which eventually hampers the productivity of the nation.

Due to its labour-intensive nature, the informal sector employees are mostly present in economic activities like agriculture, fishing, manufacturing, trading, hotels and restaurants, construction, etc. and are absent from activities that require a high level of capitalisation such as electricity and gas, finance, and so on. From the business directory of BBS, it was found that informal businesses were present in 17 broad categories in 2019. Ranking them in order of frequency, these are: Education, Manufacturing, Public administration and defence, Human health and social work activities, Financial and Insurance Activities, Accommodation and food services activities, Wholesale and retail trade, Administrative and Support Service Activities, Electricity, gas, and Air conditioning Supply, Agriculture, forestry and fishing, Transportation and storage, Construction, Information and Communication, Professional and technical activities, Mining and quarrying, Water Supply; Sewerage; Waste Management and remediation activities, and other service activities. Out of these, education, manufacturing, and public administration services comprise 91% of the entire informal businesses surveyed by BBS. Looking into the composition of these three

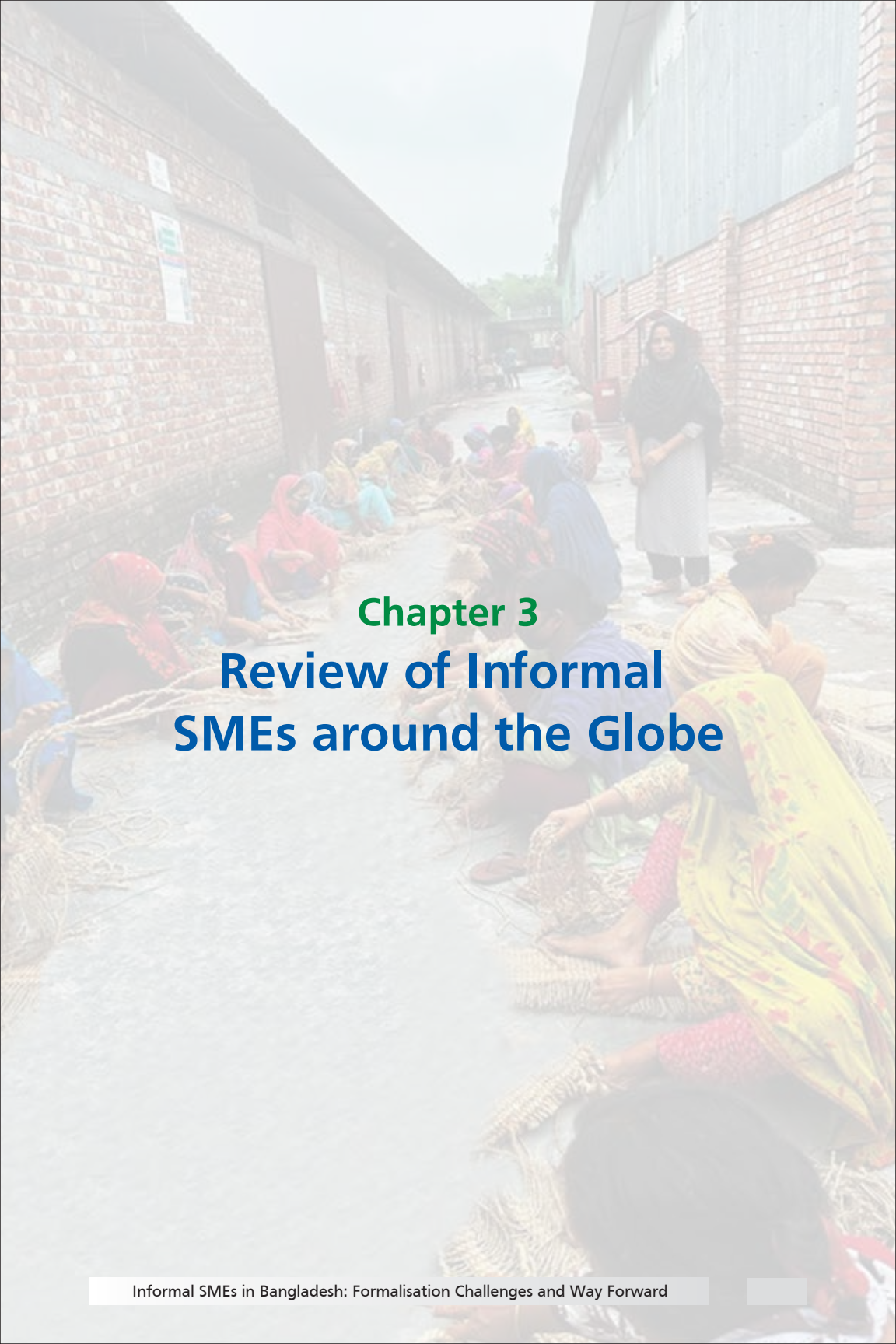
ectors revealed that print and photocopy stores, stationary shops, and tuition and coaching centres from education sector; manufacture of textile, apparel, rice mills, sugar, bakery and dairy products, wooden furniture, fertilizers, corrugated papers, etc. from the manufacturing sector; and street vendors in front of public service buildings, informal clerical staff, and traffic controllers, etc. from the public administration sector are the most common ones to be involved in informal businesses.

During the COVID-19 pandemic, many formally employed workers were forced to join the informal sector as a source of subsistence when they were fired from their respective organisations, a consequence of the elongated lockdown period. This took a toll on the GDP growth rate as it dropped from 8.15% in FY19 to 5.20% in FY20 (Bangladesh Bank, 2020). Some of the industries were critically hit such as the hotel and restaurant industry with a loss of jobs of at least 12 lakh people and the construction industry with 16 lakh+ job losses (Uddin, 2021). In the same year, working hours in the industry and service sectors declined by 11.5% and 21.6%, respectively and the labour incomes decreased by 7.1 and 17.6%, respectively (Al Mamun, Ahmed, and Islam, 2021). One upside of COVID-19 was that it led to the creation of 5 lakh jobs in e-commerce as many people opted for this form of employment (Babu, 2022), with most of these being led by women. Bangladesh is now the 46th largest country in the world for e-commerce sales, with 2,500 official e-commerce sites and a considerable number of unregistered online shops run by women selling goods valued at over \$2 billion (Liaquat, 2022). In fact, according to Meta (parent brand of Facebook), over 70% of the women-led businesses were established using the online platform, Facebook, since the outbreak of the pandemic (Liaquat, 2022), thereby acting as a blessing in disguise for these people.

While the government had announced 23 stimulus packages worth BDT 124,053 crore during COVID-19, most of these catered to the formal sector only (Uddin, 2021), leaving the informal sector in a detrimental state. The lack of a proper database of informal sector workers had made it very difficult for the government to design credit schemes solely targetting the informal sector employees. The cash support of BDT 2,500 per family, that was offered to rickshaw-pullers, day labourers, construction workers, people working at small businesses, and transport workers, was not enough to pass their livelihoods as well (Uddin, 2021).

Although informal SMEs help alleviate poverty and provide alternate sources of income, the state at which they are presently operating puts a question on the long-term productivity of the economy. Bangladesh is yet to fully realise the potential of informal SMEs (Raihan, 2021). Also,

despite the persistence of informality in the country, little to no reflection of it can be found at a national policy level. There is no way to identify the informal workers due to the lack of maintaining a consistent and comprehensive database, which is also why no targeted schemes or initiatives have been able to be properly undertaken by the government. To evade taxes and other required expenses, these businesses do not get registered and therefore do not come under the radar of the government or are not protected by labour laws (Mujeri, 2019). There is a mixed reaction from the informal employees- certain workers view it as a desirable place to work with attractive employment opportunities (Günther and Launov, 2012), while others, who have been excluded from the formal sector- either due to lack of skills or forced termination from job- view it as a last alternative (Mujeri, 2019). By fostering competition, innovation, entrepreneurship, and the spread of skills, informal SMEs can therefore greatly contribute to economic growth.



Chapter 3

Review of Informal SMEs around the Globe

3.1. Informal SMEs in Developed vs. Developing Nations

Although the informal sector has some common characteristics in both developed and developing nations, i.e., unrecorded labour, unlicensed companies, avoidance of tax, etc., the prime difference lies in the survival aspect of this sector. A literature review paper conducted by Sultana, Rahman, and Khanam (2022) found that whereas informal economy is seen as a complementary sector to support the growth of developed nations, it is greatly viewed as an attempt to survive in the developing nations and therefore has a negative connotation attached to it. This is why, SME owners in emerging or developing nations have opined that the lack of access to credit facilities for financing their businesses is one of the major barriers to expand their operations (The World Bank, 2023).

According to the International Financial Corporation (IFC) estimates, almost 40% of the formal micro, small, and medium enterprises (MSMEs) in the developing nations have to suffer due to not being able to meet their financing needs, equivalent to \$5.2 trillion, every year. The largest gap is faced by East Asia and Pacific regions, where 46% of the formal MSMEs face this problem. The issue gets more disastrous when informal enterprises are also considered in the picture. On the other hand, the outlook of SMEs is gradually changing in the developing nations. For instance, Williams (2014) revealed that a lot of the informal entrepreneurs do not necessarily work as a form of subsistence. They were not concerned about their job security and not searching for other sources of employment as they were quite content with their current area of work. Running one's own venture is often perceived as a rewarding activity as it enables talented entrepreneurs to bring about innovation and new product development although not many entrepreneurs are able to operate business into the formal sector and reach their ambitions (Mahadea, 2013; Williams, 2014).

Sultana et al. (2022) analysed the impact of the informal sector on the viability of economic development and discovered that this sector is rather detrimental to the sustainable expansion of an economy therefore policies should be deployed which will remove the informality from the sector. Some informal firms operate informally because they are not able to meet the costs of formalisation such as entry cost, operating cost, etc. and thus operate informally despite being able to meet some of the formal requirements (Abera et al., 2023). On the other hand, the 2022 World Bank enterprise survey identified that unhealthy competition takes place between the informal and formal enterprises as the former incurs lower cost of compliance, creating an

uneven playing field and impacting the performance of formal enterprises. Informal businesses cause a loss of revenue for the state in terms of non-payment of income tax and VAT (Actionaid, 2018). Moreover, it leads to a loss of regulatory control over the quality of jobs and services provided in the economy (Williams and Lanksy, 2013; VanderBerg, 2014).

This essentially indicates the need to formalise and bring the informal sector workers under a structured database which will act as a guide to implement different measures that will aid in the formalisation steps. Dasgupta (2016) tried to formulate solutions to facilitate the shift from informal to formal and found that strict legal protection should be provided in terms of worker benefits and improved working conditions and inclusive hiring policies should be adopted by organisations to reduce the entry barriers of formal job markets.

3.2. Challenges faced by Formal and Informal SMEs

There are a number of studies which highlight the issues and challenges of the SMEs, both formal and informal, which hinders their growth and expansion. Razak et al. (2018) investigated the issues and challenges that affect the growth of SMEs in Malaysia and Turkey. In Malaysia, it had been reported that SMEs contribute 98.5% and 6.1% in all the enterprises and GDP growth rate respectively. Moreover, 5.6% employment growth by SMEs had been observed compared to large firms' 3.4% employment growth. On the other hand, Turkey SMEs' 53.5% value addition was slightly lower than those in the European Union where SMEs in wholesale and retail sectors accounted for more than one-fourth of the total SME employment. Three factors- financial assistance, knowledge-based economy, and impact of marketing assistance- were analysed to explore the issues and challenges of this sector. It has been found that lack of collateral, high-interest rate, lack of proper loan documentation, ineffective management, absence of professional training program and specialised education, inadequate sales and advertisement techniques, cost of research and development, poor quality of product design, and infrequent access to local and international contact among others were the main issues hindering the prosperity of SMEs in Malaysia and Turkey.

For SMEs to cope with today's business world, Lim and Teoh (2021) examined the fundamental factors contributing to the outstanding performance of top SMEs in Malaysia. Sample data were collected from 100 Malaysian SME entrepreneurs. Strategic planning and management were identified as contributors of success while the entrepreneurs' personality traits and marketing were perceived as a critical factor

leading to the success of these SMEs who were global players as well. Nonetheless, it did not cease them from achieving a greater level of success.

Aziz et al. (2012) employed a semi-structured face-to-face in-depth interview method to find out the issues and challenges faced by the micro, small, and medium (MSM) enterprises in Malaysia's tourism and hospitality businesses. The findings show that financial burden, high overhead expenses and taxes, lack of government support, maintenance of old infrastructure, decreasing number of customers, and successor replacement were the significant obstacles experienced by MSM enterprises.

SMEs being the major contributor to Malaysian economic growth, KiatGan and Almsafir (2013) aimed to investigate the determinants of their success from an entrepreneurship perspective. Data were collected from 368 employees and employers online and face-to-face using likert-style questions. It was revealed that financial skills, social networking, creative business products and services, and entrepreneurs' level of education were the major determinants of success of the SMEs in Malaysia.

SMEs led the economic development of both developed and developing nations regarding job creation, tax provision, GDP growth, etc. But SMEs in Africa still faced numerous challenges and issues. Therefore, Muriithi (2017) explored the role of SMEs and their contributions, challenges, and solutions for Africa. The study found eight challenges of SMEs, namely electricity supply, access to finance and reliable information, negative perception of potential customers, competency, poor management, government support, and corruption and suggested appropriate solutions to mitigate the existing problems. Khandker (2014) attempted to focus on the main obstacle and challenges in the SME development of India, Pakistan, and Bangladesh where access to finance and electricity supply seemed to be the main constraints for the growth of SMEs. The study also mentioned that political instability and corruption were two of the vital challenges to the growth of SMEs in Bangladesh.

Khalil et al. (2022) used the PLS-SEM approach to investigate the factors affecting the growth of SMEs in Bangladesh, where data were collected from 216 SME owners using snowball sampling. The study showed that competition with large industries, lack of government support and protective measurement, and scarcity of technical skills were the major drawbacks for the growth of SMEs. The paper also found that

government support to mitigate funding problems is statistically significant, whereas government support to mediate competition with large firms and scarcity of technical skills are statistically insignificant.

In a research concerning 44 informal SME owners, Rao et al. (2017) described that the most frequent challenges they faced included the increased cost of raising capital, complicated and lengthy steps of obtaining loans, absence of a structured process to determine creditworthiness, information asymmetry, and lower level of financial awareness and education. It is essentially a chain reaction where the lack of knowledge prevents the SME owners from opting for relevant financing options and getting their enterprises formally registered, which in turn, makes it difficult for them to obtain loans as their creditworthiness cannot be properly deemed. To tackle these problems, the Indian Government has introduced the 4Es initiative, referring to enterprise creation, employment generation, export, and ease of doing business to make the SMEs globally competitive (Ranjan, 2021).

Due to their nature, informal SMEs are prone to both financial and non-financial hindrances. Major non-financial obstacles for the SMEs situated at Gazaland Market, Zimbabwe included the absence of government support, discriminatory treatment from local authorities, lack of training, lower trust among suppliers, etc. (Tinarwo, 2016). The lack of leadership, research and development, management and marketing skills, and absence of a well-defined regulatory infrastructure often made it difficult for the informal manufacturing SMEs in Zimbabwe to thrive for a longer period of time (Matsongoni and Mutambara, 2021).

3.3. Challenges faced by Informal SMEs during Formalisation

Informal SMEs play a vital role in the development of economic growth worldwide, particularly in Asian and African developing countries. Matsongoni and Mutambara (2018) used a theoretical approach to assess the challenges that have affected the development of informal SMEs worldwide. The study found access to finance, lack of management and operational skills, poor leadership, location, marketing and networking, how to start a business formally, lack of financial literacy, lack of technological capability, lack of adequate government policies, and legal and regulatory framework and poor implementations of existence legal framework etc. to be the main challenges of the informal SMEs. Moreover, the paper proposed the way forward for the formalisation of informal SMEs based on the five key pillars- development of a supporting legal and regulatory framework,

effective government policy, registration framework, favourable financial infrastructure, and appropriate and latest technology.

Chijikwa and Mulenga (2023) used descriptive and quantitative research designs to investigate the factors working as obstacles to the formalisation of SMEs in the Chilenje Market of Lusaka, Zambia. The study concluded that the level of entrepreneurs' education, awareness of government services, cost of formalisation, laws and policies on formalisation, and lastly, level of satisfaction with government services were the direct contributing factors for the decision to either formalise the SMEs or not. The paper further recommended that the Government should offer business training for owners, an affordable credit scheme, improved communication strategy, and ensure proper implementation of laws and policy to transform the informal SMEs into a formal economy.

Koshy (2019) examined the challenges and opportunities for integrating the informal sector into the formal sector. Lack of awareness of the benefits of the formal sector, absence of formal education, digital and financial illiteracy, lack of government incentives, high operating expenses, and complicated registration process had been found to be the obstacles to transform informal MSMEs into formal enterprises. The paper suggested that wide networking, support services such as information on registration, tax filing, regulatory requirement, and post loan monitoring support system should be provided to facilitate formal transition of MSMEs. Maniraguha (2020) found that long term motives of enterprises' owners, government policy, and cashless payment systems were the means for formalising informal enterprises in Rwanda. The paper also showed that high taxation, availability of markets, and lengthy procedures of getting legal documents were the real barriers for formalising informal enterprises.

In an unsuccessful attempt to formalise the informal sector, the Indian government devalued its higher-denomination currencies in 2016 so that the currently circulated currencies could be withdrawn, resulting in a shortage of physical money in the market and forcing people to opt for cashless transactions (Bhattacharya, 2019). Although a lot of the informal business owners shifted to this mode of transaction, once the currency was replaced, they went back to their preferred way of cash-based transactions. Digging deeper behind the reasons of informal SME owners for not getting their businesses registered, Vij, Khanna, and Srivastava (2017) discovered that these people found the entire process quite complex due to excessive paperwork, having to deal with government units, inclusion of complicated legal terms that were above

their comprehension level, and numerous steps that they could not keep track of. These findings were aligned with that of Pachouri and Sharma (2016)'s, who stated that most MSMEs were apprehensive of the time-consuming nature of the registration process for which they viewed formalisation-related public policies as hindrances instead of facilitators for the growth and development of MSMEs.

De Mel et al. (2013) mentioned that tax payment and frequent visits of tax authorities, the lengthy registration process, and initial high registration cost were the possible consequences of formalising informal firms in Sri Lanka. Not having enough fund to finance business operations, lack of access to advanced technology, and lower literacy rates of informal SME owners greatly hindered the development of SMEs in this country (Amaradiwakara and Gunatilake, 2016). The same study found that government regulations related to the import of raw materials prevented many SMEs from further expanding their businesses into international markets. Niranjala and Jianguo (2017) found that despite wanting to know about the ways of financing their business, SME owners could not take commercial loans due to high interest rates and lack of banking facilities in rural areas. Interesting research focused on women entrepreneurs working in the Sri Lankan informal economy highlighted that most poverty reduction initiatives were centred on providing them with financial support and technical guidance, which ultimately resulted in only moderate success of these female-led SMEs (Wijewardena et al., 2023). Instead, initiatives that rather leveraged the mindset of these women entrepreneurs proved to be more stimulating in obtaining favourable responses from them.

The efforts behind formalising informal SMEs greatly came to a halt due to the onset of COVID-19 pandemic. A serious drop in demand, followed by working capital shortages, new forms of work schedules (work from home), lockdowns, etc. were the top concerns posed by the informal MSMEs of Indonesia (Shinozaki, 2022). They also wanted a comprehensive information platform that would elaborately explain the government incentive programs so they can avail their full benefits as well as elaborate training programs on enhancing their digital technology literacy.

Just as government support is needed to flourish the informal economy, it is also needed to formalise the informal sector. For instance, Singapore had established a law that no hawker could operate without gaining a valid license from the Singapore Food Agency, and he/she would be charged up to S\$ 5,000 for committing the offence (Organisation for Economic Co-operation and Development (OECD), 2020). While it is

important to reduce the entry costs for informal enterprises, governments must strike the right balance between lowering the cost levels and ensuring the proper infrastructure support required for businesses. If quality is compromised to reduce the cost, the informal turned formal businesses will not be sustainable in the long run (ibid p. 39).

One of the biggest challenges faced in formalising this economy entails the registration process of informal SMEs. Regulators and policymakers need to convince the SME owners with incentives like providing lucrative market opportunities, expanding capacity, streamlining the overall registration process, etc. An experiment conducted in Malawi, providing such business entities free registrations along with complementary knowledge sharing sessions, had resulted in a 70% rise in businesses getting themselves registered (Stein, Ardic, and Hommes, 2013).

3.4. Challenges faced by Women-led Informal SMEs

Almost 22% of SMEs in Bangladesh are led by women (Eusuf, Khan, and Rahman, 2020), of which the percentage of informal SMEs dominate in number. While the percentage of women in informal employment is lower than that of men, the share of women as contributing family workers, a sector which is mostly unpaid, is almost three times that of their counterpart, placing them at a defenceless position (ILO, 2018). A policy brief by UN Women (2020) stated that 60% of women in Bangladesh do not have access to financing options due to sociocultural, economical and institutional barriers, have lower exposure to information and communication technology, and have less diverse network resources. In fact, many times, women feel uncomfortable to start their business if they do not get the necessary moral support from the prominent male figures of their families (Eusuf et al., 2020). Also, it is difficult to obtain guarantors for these women when they want to take loans, as a result, they have to start their businesses with their own savings (Ahmed, 2019).

As per the Labour Force Survey 2022, most Bangladeshi women (96.6%) worked in the informal sector and were considered to have been impacted the greatest by COVID-19 (Bidisha, 2023). This, coupled with their declining presence in RMG and increasing presence in the agriculture sector, might indicate their prominent role as unpaid family workers, especially in the rural areas. In addition to that, as the lockdown was imposed and family members were forced to stay at home, the responsibility of household chores was amplified for these women (Saqui and Mehjabeen, 2023). A report by Advocacy for Social Change [ASC] (2020) identified the core challenges that women-led informal enterprises faced included having no income due to business

not being in operation, having a lack of demand for their products, not receiving fair prices, facing capital shortage, and trouble in procuring raw materials. The higher economic burden often damaged the mental health of the women entrepreneurs.

Chinnappan (2016) delved into the conditions of women who were engaged in train hawking in Mumbai, India. Although they were more in number, they were in constant fear of police ousting them from their locations. This prevented them from holding any protests for their rights. The paper had urged the media agencies to shed light on these people; not under the titles of 'hawkers', 'beggars', etc. rather as individual human beings with their own set of rights and needs. However, there has been an attitudinal shift in the female participants of informal economy where they are ready to sacrifice a portion of their wages in exchange of receiving health benefits (The Economic Times, 2023).

Noor and Filzah (2020) stated that the issue is grave in Pakistan as women are forced to work in informal sectors where they face issues with accessing finance and having lower literacy rates as well as entrepreneurial and managerial skills. Another Pakistan-based study by Hasan, Khan, and Arif (2022) revealed that most women-led businesses are conducted in social media platforms having inaccurate or partial information on the benefits of formalisation.

A major problem for women entrepreneurs in Sri Lanka resulted from the fact that access to bank loans is dependent on land rights (Handaragama and Kusakabe, 2021). Because women there have relatively fewer rights than men, they face significant difficulty in securing loans for their businesses. Apart from that, the deeply embedded gender bias issues put the growth of these businesses at risk.

3.5. Global Best Practices in managing the Informal SMEs

This section provides a review of some of the best practices in the South Asian and South East Asian countries.

| India: SME Rating Agency of India (SMERA) |

India has one of the most dynamic micro, small and medium enterprise (MSME) system in the world. To fulfil the demands of MSMEs in relation to access to finance, an SME Rating Agency of India (SMERA) was established. It is a rating and research agency set up for MSME in India which provides ratings enabling MSMEs to raise loans at competitive interest rates. It was established in 2005 with a collaboration between the Ministry of Finance, Government of India, and Reserve Bank of

India. To get support from SMERA, companies need to be registered. To help start-ups access early-stage finance, it also introduced New Enterprise Credibility Score (NESC) for them.

In offering better access to finance to registered business when they opt for formalisation, rating agency like SMERA can play crucial role in motivating business to formalise. Besides, the impact of SMERA involves-

- As of 2023, SMERA has completed over 50,000 ratings across sectors and geographies in India.
- As of 2022, it introduced new products such as real estate project, developer grading and techno economic validity report.
- During 2020, a fintech platform known as SMERA Banker's Terminal is created by SMERA that interlinks bankers with potential SME borrowers.
- It integrated tamper-proof QR Codes in SME rating reports to facilitate easy access to information in 2017.
- In 2014, it set up Credit Due Diligence Offering to validate an entity's claims.
- To improve the credit flow to the MSME sector, SMERA is recognised as a novel and sustainable initiative of the Government of India by the International Finance Corporation

Since informal SMEs do not have access to the formal credit sector, they usually take loans at a high interest rate from the informal credit market. If informal SMEs' overall creditworthiness can be rated by a designated rating agency, it might help financial institutions review the financial capability of informal SMEs in granting loans. In Bangladesh, the Bangladesh Rating Agency Ltd. (BDRAL) is specialised in rating small and medium enterprises. To encourage informal SMEs to get registered and get support from rating agencies, the Government of Bangladesh can approve rating agencies like BDRAL.

| Singapore: Hawker Centres |

The hawker centres are built to provide hygiene and sanitary alternatives to mobile hawker carts, which contain several stalls selling varieties of affordable meals. The Singapore hawker centres are basically large food courts with stalls serving from full meals to snacks and drinks. The steps taken by the Singapore Government to establish hawker centres-

- To legalise the hawkers, the Government of Singapore conducted an island-wide census from 1968 to 1969.

- Temporary hawking licenses were issued to some 18,000 hawkers who sold cooked food, household items and fresh produce on the streets.
- To curb illegal hawkers who were operating their businesses without registration patrols and raids were carried out.
- Licensed hawkers were relocated from the streets to purpose-built buildings named "market and hawker centres or hawker centres by the Government of Singapore in the early 1970s.
- From 1971 to 1985, the Government engaged in a programme to build hawker centres with infrastructures to enable them to operate their businesses under hygienic conditions,
- In 2001, to improve the structure of more than 1000 hawker centres, the Government launched the Hawker Centres Upgrading Programme.

Emerging economies can take the lesson from this initiative to establish effective regulations requiring informal businesses to register. To bring informal business under the umbrella of registration, significant efforts have been made by the government to enhance hawker centres such as

- Today, there are 114 hawker centres in Singapore that house more than 13,000 stalls.
- Citizens or Permanent Residents of Singapore can apply for a hawker license.
- As of September 2020, there were 13,785 licensed hawkers, of which 97% operated in the hawker centres.
- To operate as a hawker without acquiring a license by any person is considered an offence, and a fine of up to \$5,000 will be charged to any person found guilty.
- A commission of a subsequent offence will be subject to a fine of up to Singapore dollar 10,000, imprisonment of a maximum of three months, or both.
- According to the Consumers Association of Bangladesh, 97,000 to 200,000 street food vendors sell a variety of prepared foods. However, most of them run their business illegally and unhygienically. They occupy footpaths and parts of roads in cities, causing suffering to the movement of pedestrians. Therefore, concerned authorities from the Government should take necessary steps in bringing them into the registration process and choose designated places and times for them to run the business with proper maintenance of food standards.

| Vietnam: Tax Reforms |

After being formalised in Vietnam, efforts were made to simplify tax filing processes and introduce digital Government services in 2019 to reduce the burden of financial and regulatory compliance for micro-enterprises.

Bangladesh can learn from this to reduce its costs of entry to business and streamline business registration. Also, a reformation of the tax system for the informal sector is necessary. Vietnam has experienced the following success since reforming the tax filing procedures-

- Due to the annulment of the mandatory 12-month carry-forward period for VAT credit, paying taxes has become easier.
- According to the Doing Business 2018 report, Vietnam has made the most progress in the paying taxes indicator ranking.
- Vietnam was ranked fourth in tax reforms, after Singapore, Thailand, and Malaysia.
- In addition, Vietnam has introduced an online platform for filing social security contributions.
- Currently, there are nearly 98% of registered micro, small, and medium enterprises (MSMEs) filing tax forms and paying taxes online.

In Bangladesh, due to the obligation of a 7% advance income tax deduction on the sale of products by SMEs, large industrial companies have lost interest in buying products from SMEs. Instead, they have started producing their products to be relieved from paying 7% advance income tax. Therefore, preferential tax regimes should be introduced for SMEs, such as lower tax rates and easier taxation, since most of the backward linkage industries belong to them.

| Malaysia: MalaysiaBiz Portal |

MalaysiaBiz Portal was developed by the Malaysian Administrative Modernisation and Management Planning Unit (MAMPU) to provide information on registration and licensing to facilitate business start-ups.

- It provides a helpdesk service for creating inquiries based on general topics regarding the portal, registration, licensing, payment, and technical issues through e-support.
- It also provides online business registration and licensing application services for selected agencies.

This practice is a great example of reducing the registration burden through digitalising the business registration process. Online business registration not only facilitates data collection but also helps disseminate

data among various parties working with the business. As of 2020, 17 system registrants and licensing authorities are associated with the program, and information on 2,919 licenses from 508 licensing authorities is available.

The introduction of an online platform for informal SMEs of Bangladesh is needed to get all the services, including business registration, tax filing, renewal of trade licenses, counselling about how to start a business, skill development training, etc. Therefore, in 2022, SME Foundation and Aspire to Innovate (a2i) announced that they will jointly develop over 8,250 digital centres nationwide as one-stop service centres for local SMEs. Moreover, an SME e-database programme under SME Foundation, Bangladesh, has been launched where SME entrepreneurs will get services easily if they get registered in the e-database.

I Malaysia: Women Netpreneur Programme I

This program aims to provide the knowledge and skillset to help women entrepreneurs enter the online market or promote their existing businesses via digital and e-commerce platforms.

- The Women Netpreneur program was developed in 2013 to ensure that women entrepreneurs are kept informed about the changing business landscapes emerging from the megatrends of the new world.
- This program focuses on helping women entrepreneurs start and grow businesses online. It is conducted by a collaboration between SME Corp. Malaysia, Malaysia Digital Economy Corporation, and Gorgeous Geeks Malaysia.
- The partners in the program also include Presto Mall, Lelong, Facebook, Shopee, Buy Malaysia (MPay) and Global Halal Data Pool.

The initiative sheds light on the digitalisation procedure to improve the business of women entrepreneurs serving SMEs. It has been reported that-

- As of 2021, about 2280 women have been trained by the Women Netpreneurs
- After that, 80% of women entrepreneurs has subscribed to e-commerce platforms like Shopee, Facebook, and Presto Mall and 55% are willing to invest to start an online business based on the feedback from participants in the Women Netpreneur programme.
- Women Netpreneur is expected to benefit 480 women entrepreneurs.

- Programmes designed specifically for women entrepreneurs such as e-commerce training, art courses, child-care workshops, creative sewing and beauty courses have benefitted 1671 participants as of 2021.

According to the BBS, there were about 24.6% female owned SMEs in Bangladesh in year 2020. Women entrepreneurs in Bangladesh face various problems. One of them is the adoption of digitalisation process into their business. More helping centers such as “Tottho Apa” (meaning Information sister or Information guide as translated) should be built to provide information and service to women entrepreneurs. Aspire to Innovate (A2i), a Bangladesh Government program, established an e-commerce platform named EK Shop that helps improve market access for entrepreneurs especially rural areas-based women entrepreneurs.

A photograph of a group of women in a brick alleyway, likely in Bangladesh, engaged in traditional jute processing. The women are sitting on the ground, surrounded by large piles of jute fibers. They are wearing colorful saris and headscarves. A woman in a black headscarf and grey dress stands in the background, looking towards the camera. The alleyway is flanked by brick buildings, and the ground is paved. The scene is captured in a slightly faded, artistic style.

Chapter 4

Research Methods

4.1. Introduction to Research Methods

This chapter outlines the methods, techniques, and procedures used to gather data, analyse information, and draw conclusions. In formulating a reality description, quantitative and qualitative knowledge are important to the researcher (Lewis and Cullis, 1990, cited in Kreander, 2002). Moreover, O'Dwyer (1999) argues that knowledge can also be gained by studying the perception of individuals rather than by only studying an event that is external to the individual's perceptions. Thus, to fulfil the study's objectives, this research employs a pragmatic approach and uses mixed methods of research (Creswell, 1998), which is visually depicted below.

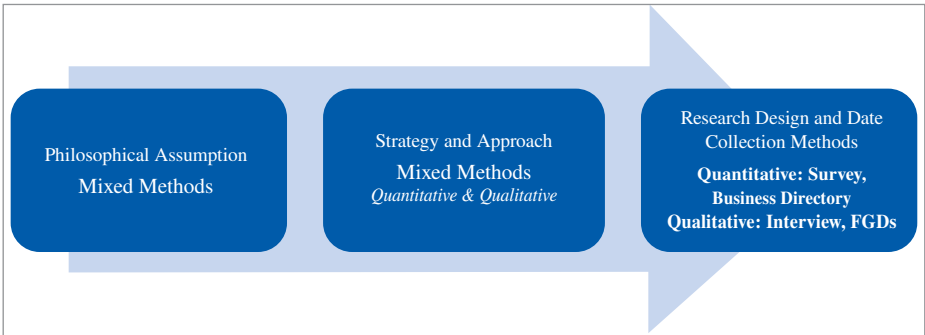


Figure 9: Approaches to Research Methods

The researchers collect both quantitative and qualitative data from primary and secondary sources to understand the current state of informal SME enterprises in Bangladesh, their size and contribution, the hurdles they face, the challenges in formalising informal SMEs, and the way forward.

The objective of the quantitative part is to understand the current status of informal SMEs, to investigate the factors for becoming formal and the potential challenges of the informal SMEs in becoming formal.

The qualitative investigation requires an understanding of the social, economic, and institutional context of informal SMEs in Bangladesh. Thus, interaction with institutions, organisations, and society is necessary to explore the challenges of formalising informal SMEs and the way forward.

The objective of the qualitative part is to explore the following:

- The key characteristics and the challenges faced by informal SMEs in Bangladesh;
- The perceptions and attitudes of informal SME owners towards formalisation and

- The potential barriers and enablers for formalising the informal SMEs in Bangladesh.

The study deploys a convergent (concurrent) mixed methods design. The key assumptions of concurrent mixed methods are that both quantitative and qualitative methods provide different types of information (Creswell, 2003). Once the data have been collected and analysed through both qualitative and quantitative methods, the results will be merged to interpret them and identify the common and distinguishable findings.

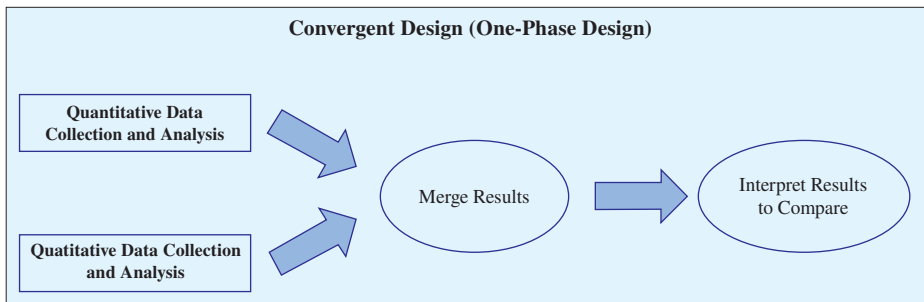


Figure 10: Convergent Mixed Methods Research Design

As explained and categorized in Onwuegbuzie and Johnson (2006), in basic concurrent mixed designs, the following conditions hold:

- Both quantitative and qualitative data are collected separately and at approximately the same point in time;
- Neither the quantitative nor the qualitative data analysis builds on the other during the data analysis stage;
- The results from each type of analysis are not consolidated at the interpretation stage until both sets of data have been collected and analysed separately; and
- After collecting and interpreting data from the quantitative and qualitative components, a meta-inference is drawn that connects the inferences made from separate quantitative and qualitative data and findings.

Steps in the Research Design

The following states the activities of the research design of the study.

§ Step 1: Secondary research (Literature review)

§ Step 2: Discussion guide preparation (separate for each group of participants)

§ Step 3: Qualitative interviews, transcription

§ Step 4: Focus Group Discussions and Transcriptions

- § Step 5: Theme generation — parallelly from Interviews and FGDs
- § Step 6: Survey questionnaire development simultaneously
- § Step 7: Pilot testing of the survey instrument, feedback incorporation, honing
- § Step 8: Continuation of qualitative interviews, DATA collection for quantitative
- § Step 9: Theme generation
- § Step 10: Analysis plan development
- § Step 11: Data cleaning, processing, open-ended coding, and merging
- § Step 12: Analysis of quantitative data, Charts and table creation
- § Step 13: Compare and contrast qualitative and quantitative findings to address objectives and recommendations for policy implications

4.2. Quantitative Research Methods

Target population

For the empirical analysis, the target population primarily includes the informal SMEs in Bangladesh in the manufacturing, trade, and service sectors. The characteristics and definition of the informal SMEs are based on the Industrial Policy 2022. The specific industry sectors considered in this research are trade services, clothing businesses, education, poultry farming and fisheries, restaurants and food services, etc., based on the Business Directory 2019 by BBS.

Sampling technique

Random sampling (Babbitt et al., 2015) has been applied to gather responses for the survey questionnaire. We adopted probability sampling to gather respondents from different parts of Bangladesh. Non-probability sampling limits the ability to draw generalisations about the target population (Saunders et al., 2019). In this context, it might be a pragmatic choice to choose random sampling because of the resources we have available from Business Directory 2019 by BBS.

| Survey Instruments |

To collect data based on random sampling, we adopted survey instruments such as a Questionnaire (Ishengoma, 2018) and an Interview survey (William & Shahid, 2014). The questionnaire is a research instrument designed to capture respondents' responses in a standard manner. We have chosen a close-ended questionnaire where informal SME owners were asked to answer based on a given set of choices. The response format of the questionnaire includes dichotomous

responses of “Yes and No”, whereas questions regarding gender and educational level were captured using nominal responses. Moreover, questions regarding the challenges of informal SMEs in becoming formal were collected using interval-level responses such as the “Five Point Likert Scale”. Finally, data on the age of the owners, years of business operation, number of employees and sales were collected using continuous response. To collect data using the prepared questionnaire, we followed an interview survey method where 64 samples were collected for pilot testing, 204 samples were collected by conducting face-to-face Interviews, and 59 samples were collected by adopting telephone interviews, which were unavailable for face-to-face Interviews.

| Data Collection |

We collected data from 327 informal business owners in Bangladesh. The sample SMEs have been drawn from both urban and rural areas of Bangladesh, covering manufacturing, retail and service industries. The sample SMEs are diverse in age and number of employees and include both male and female-owned businesses. A pilot study of 64 samples was conducted from August 7 to August 10, 2023, to improve and refine the instructions and contents of the questionnaire. The questionnaire was pre-tested with a few respondents for face validity (Sarstedt & Mooi, 2019). Finally, to gather data on demographic characteristics, factors motivating informal SMEs owners to formalise their businesses and challenges of the informal SMEs in becoming formal, both face-to-face and telephone interviews were conducted in Dhaka, Chattogram, Khulna, Rajshahi and Sylhet divisions of Bangladesh in August. Data was collected using the software named Surveyhive. Enumerators were trained correctly, and a total of 263 respondents were interviewed. Among them, 23 samples were excluded from the analysis as these businesses had already been registered. Finally, we have chosen a sample size of 304, considering the sample of the pilot survey and full survey conducted using the software named Surveyhive. The summary of the final survey data is given in the following table:

Table 15: Summary of Primary Data Collection

All Respondents	Total	Face to Face	Telephone	Male	Female
Dhaka	136	124	12	123	13
Chattogram	117	107	10	101	16
Khulna	10	0	10	9	1
Rajshahi	7	0	7	3	4
Sylhet	34	30	4	26	8
Total	304	261	43	262	42

| Data Processing and Cleaning |

The chosen data surveyor company followed the data processing and cleaning procedures to arrive at the final dataset. The purpose of data processing was to collect, manipulate and process collected data to arrive at a more meaningful and informative dataset. On the other hand, data cleaning was done to fix or remove incomplete, corrupted, incorrect or duplicate data from the dataset. To clean the data, the Quality Check (QC) protocol was followed where 5% of the interviews were backchecked, 10% of the interviews were backchecked by Telephonic Back Check (TBC) and Audio Back Check (ABC) was used to check another 10% of the interviews. Finally, for the values of sales, they checked to identify if any outliers were present.

| Variables |

The variables used for the empirical analysis, along with their definitions and previous literature, are provided later in this section. The dependent variable, Motivation to formalise, is a dummy variable that takes a value of "1" if the informal business owners are motivated to formalise their businesses or "0" if they are not (William & Shahid, 2014; Ishengoma, 2018; Mukorera, 2019).

The independent variables have been selected based on the literature reviews. Some are selected based on the FGDs and Key Informant Interviews that were conducted, as some variables are important from the institutional context of Bangladesh. The independent variables are dummy variables consisting of the dichotomous response of "1" and "0". The description of the independent variables is as follows:

| Interest Rate |

Interest rate is the price for using money or the amount charged for a loan (Uddin, 2019). Banks hesitate to provide loans to SMEs because they perceive the business models of many SMEs may not be sustainable. Therefore, SMEs in Bangladesh obtain credits from informal lenders at a very high interest rate (Raihan, 2021). De Paula & Scheinkman (2007) estimated in their data set that informal firms faced an interest rate that is at least 1.3 times the rate of interest faced by formal firms. Ali and Islam (2018) found that SMEs in Bangladesh have to pay, on average, 14.44% interest on formal credit and 31.22% on non-formal credit. Therefore, based on the information above, the following hypothesis is developed:

H1: A low interest rate level motivates informal SME owners to formalise.

Collateral Requirement

Collateral works as a security for a loan and reduces the risk of default as the lender can recover the loan amount by selling it in the market. Most informal SMEs are small in size. They are asked to provide proper collateral documentation whenever they need finance with low interest rates from the formal credit sector. Hoque et al. (2016) found that 44.5% of respondents in Bangladesh did not apply for bank loans because of being unable to provide collateral. Menkhoff et al. (2012) found that borrowers of the SME sector in less developed countries have lower levels of assets to pledge as collateral security to banks. The probability of credit rationing is higher for them in these countries. Using the World Business Environment Survey (WBES), Beck et al. (2006) found that collateral requirements are one of the most important difficulties in financing SMEs. Considering the collateral requirement for a loan, the hypothesis is as follows:

H2: Flexible collateral requirement motivates informal SME owners to formalise.

Aware of the Formalisation Benefit

A dummy variable that takes one if the owner of the informal SME is aware of the benefits of formalisation; otherwise, 0. From the focus group discussions and key informant interviews, we found that informal SMEs are unaware of the benefits associated with formalising the business. They are unaware of the benefits such as low interest rates on loans from the formal credit sector, better access to finance, and financing schemes for SMEs, especially women-based SMEs. According to Nohoua (2021), due to the presence of information asymmetry, informal entrepreneurs have little to no information on the opportunities, conditions, and advantages they could benefit from by working closely with the state if they are registered. The focus group discussions and key informant interviews helped us formulate the following hypothesis.

H3: Awareness of the formalisation benefits motivates informal SME owners to formalise.

One-Stop Regulatory System

A one-stop regulatory system is needed to reduce the processes, time and cost of starting and registering a business. Moreover, this system is needed to access information regarding trade licenses and legal documents, such as VAT, e-TIN certificates, etc., from one place. An informal business with no digital connectivity can avail of registration service from the nearest Government Digital Centre and might get

motivated to formalise the business. After an online interview with the correspondent from a2i (a Bangladesh Government Organisation) on July 12, 2023, the variable was chosen as a dummy variable, which takes the value of 1 if Government introduces one-stop regulatory system, 0 if not and the following hypothesis is developed:

H4: Introducing a one-stop regulatory system motivates informal SME owners to formalise.

Registration Process

The ease of registration is a major factor motivating informal SMEs to formalise their business. Securing registration from different authorities such as the tax and labour department requires a number of procedures, time and costs. By simplifying the registration process and introducing one stop service to eliminate the need to visit several departments of government, formalisation will increase. In Bangladesh, to get a trade license, business owners need to go to the offices of concerned authorities 3-4 times. Therefore, a dummy variable is set where it takes a value of 1 if the registration process is less complicated to understand and apply, otherwise 0. Mukorera (2019) found a significant positive relation between the business registration process and willingness to formalise the informal enterprises. On the contrary, William and Shahid (2014) did not find any significant relationship between degree of registration and degree of formalisation of entrepreneurs in Pakistan. Based on the literatures and Focus group discussion, we developed the following hypothesis:

H5: Less complicated registration process to obtain trade license motivates informal SMEs owners to formalise.

Adoption of Technology

The adoption of technology by SMEs and SME agility have been found to be related (Khalil et al., 2022). A lack of technological advancements hinders owners and employees of informal enterprises. Many small firms' employees cannot operate their businesses digitally because of issues with accepting the latest technology. Most SMEs in Bangladesh produce items using local equipment and in-house technologies (Alauddin et al., 2015). To find out whether informal SMEs are motivated to register their business, dummy variable one was chosen if employees are capable of adopting technology easily otherwise 0 and the following hypothesis is developed:

H6: Employees' capability to adopt technology easily motivates informal SME owners to formalise.

Financial Support from Government

Every government ministry and agency in Bangladesh has its own set of requirements for starting a business, no matter how small or large the business will be. Filling out the paperwork is difficult for the average person (Nyandoro, 2016; Yoshino, 2016). Moreover, they must pay a large sum for a trade license and bribes to almost every desk to complete the job. If the Bangladesh Government takes an approach to providing financial support to those small informal SMEs to get done with the registration process, formalisation will increase. Considering this, the following hypothesis is developed:

H7: Financial support from the Government to obtain trade licenses motivates informal SME owners to formalise.

Training Program by Government

There are training programs and market fairs for formal sector entrepreneurs and employees. Owners and employees of the informal sector are not usually invited to attend any training program regarding operating a business in Bangladesh. Rakotomanana (2009) found a positive effect on the willingness of informal businesses to register for formal vocational training in Madagascar. Therefore, the variable training program by the government for entrepreneurs and employees was chosen to see its impact on the degree of formalisation and the following hypothesis is constructed:

H8: Government training programs for entrepreneurs and employees motivate informal SME owners to formalise.

Control Variables

To capture the impact of sales, years of business operations and the number of employees on the degree of formalisation by informal SMEs, they were chosen as control variables for the model (Zylfijaj et al., 2020). The impact of years of business operations on the degree of formalisation has been investigated by William and Shahid (2014), Ishengoma (2018), Moaaz and Mansour (2023), etc. while Nohoua (2021) and Zylfijaj et al. (2020) took employment to see its impact on formalisation.

Econometrics Model

As the dependent variable considered for this model is motivation to formalise, which is in the form of a dummy variable therefore, the logistic regression model has been chosen to run the hypotheses discussed above because the ordinary least squares (OLS) method would ultimately result in a linear probability model (LPM) but the assumption

of the LPM that limits the applicability of OLS in such a scenario. Two significant drawbacks of LPM are that the fitted probabilities can be less than zero or greater than one and that the partial effects of any explanatory variable are constant (Wooldridge, 2013). For this reason, parameters have been estimated using a logit model.

Model Specified

Based on the hypotheses set above, the following equation was developed:

$$\ln[P(\text{FMLt})/(1-P(\text{FMLt}))] = b_0 + b_1 \text{IRi} + b_2 \text{COLLi} + b_3 \text{AWRNSi} + b_4 \text{OneStopi} + b_5 \text{REGi} + b_6 \text{TECHi} + b_7 \text{Fin_Govti} + b_8 \text{TNGi} + b_9 \text{Log_salesi} + b_{10} \text{AGEi} + b_{11} \text{EEi} + u_i$$

In this equation, the dependent variable is the log of the odds ratio, where P (Formalise) is the probability of an event coded with 1. u_i is the error term in the model, which is termed as other factors. Based on the discussion of the variables and econometrics model, the operationalisation of the variables is presented on the next page.

Table 16: Operationalisation of the Variables

Variables	Nature of the Variables	Symbols	Description	Empirical Studies
Motivation to formalise	Dependent Variable	FML	Dummy 1 if informal business owner is motivated to formalise, 0 if not.	William and Shahid (2014); Ishengoma (2018); Mukorera (2019).
Low Interest rate	Independent Variable	IR	Dummy 1 if low level of interest rate is offered, 0 if not.	Raihan (2021); De Paula and Scheinkman (2007); Ali and Islam (2018); Uddin (2019).
Collateral requirement	Independent Variable	COLL	Dummy 1 if flexible loan collateral requirement is provided, 0 if not.	Hoque et al. (2016); Menkhoff et al.(2012); Beck et al. (2006).
Aware of the formalisation benefits	Independent Variable	AWRNS	Dummy 1 if informal business owner is aware of the formalisation benefits, 0 if not.	FGD Session 1; Nohoua(2021).
One stop regulatory system	Independent Variable	OneStop	Dummy 1 if one stop regulatory system is introduced, otherwise 0.	FGD Session 1; KII Session 1; Policy Insights; Formalisation in the Asean countries.
Registration process	Independent Variable	REG	Dummy 1 if the registration process to obtain trade license is less complicated, otherwise 0.	Mukorera (2019); William and Shahid (2014).
Adoption of technology	Independent Variable	TECH	Dummy 1 if employees of informal businesses are capable of adopting technology, otherwise 0.	Khalil et al. (2022); Mukorera (2019); Alauddin et al.(2015).
Financial Support from Government	Independent Variable	Fin_Govt.	Dummy 1 if government provides financial support to obtain trade license, if not 0.	Nguyen et al. (2014); Nyandoro (2016); Yoshino (2016).
Training Program by Government	Independent Variable	TNG	Dummy 1 if government organises training program for entrepreneurs and employees, otherwise 0.	Nohoua (2021); Rakotomanana (2009).
Log of Sales	Control Variable	Log_sales	Natural log of monthly average sales of the business	Zylfijaj et al. (2020).
Years of Operation	Control Variable	AGE	Years of Operation = 2023 minus year of establishment	William and Shahid (2014); Ishengoma (2018); Moaazand Mansour (2023); Zylfijaj et al. (2020).
Total Employee	Control Variable	EE	Total number of employees of the business.	Nohoua (2021); Zylfijaj et al. (2020).

4.3. Qualitative Research Methods

The qualitative data has been collected primarily through in-depth semi structured interviews (O'Dwyer, Unerman and Bradley, 2005; Cassell and Symon, 2004; Holloway and Wheeler 2010), Focus Group Discussions (FGDs), Group Interview (Hennink and Leavy, 2014), published documents and reports, government policies, and circulars.

The researchers conducted two Focus Group Discussions (FGD). The rationale for conducting the FGDs was to rely on the interaction within the group that is generated from the topics supplied by the researcher (Morgan, 1997). It is this interactive element of focus group research which is the defining feature, and which offers the potential for the creation of new research paradigms (Kitzinger, 1994, 1995; Madriz, 2000; Barbour, 2008; Hennink and Leavy, 2014). It is the richness of the data arising from the interactions between group members that contributes an added level of understanding that would not otherwise be present in the narrative (Kitzinger, 1994).

(1) The first FGD was conducted with the policymakers, researchers, development organisations working with informal and formal SMEs, Central Bank (Bangladesh Bank) officials, ministry, academic, and a SME owner. The objective of the FGD was to understand the current situation of the informal SMEs, the motivations for formalisation of the SMEs, the challenges of the formalisation and the way forward. The number of participants were 8 and the FGD was conducted for 2 hours moderated by the lead researcher and co-researcher. The FGD was audio taped and notes were taken.

The FGD was conducted at the conference room of the Institute of Business Administration, University of Dhaka. The FGD was conducted for two hours and was moderated by the lead researcher with the help from the co-researcher. The participants discussed the current status of the informal SMEs and the challenges of formalisation process. The FGDs were conducted in mixed English and Bengali.

(2) The second FGD was conducted with formal and informal SME owners to understand their awareness and motivation for formalisation, the challenges they face while being informal and their perceptions and attitudes towards formalisation of their enterprises. The number of participants were 10 and it was conducted at the conference room of the Faculty of Business Studies (FBS), University of Dhaka. The FGD was for 1 hour and the entire discussion was recorded.

I In-depth Interviews and Group Interview I

The researchers conducted 6 in-depth semi structured interviews with different stakeholders; SME owners, policy advocates, economist, academic, president and member of associations of informal SMEs to get an insight into the context of informal SMEs, their suggestions on the challenges and perceptions of formalisation process, and how to mitigate the challenges and hurdles. The in-depth interviews provided the opportunity for the researcher to probe deeply to uncover new clues, open up new dimensions of a problem and to secure vivid, inclusive accounts that are based on personal experience (Burgess, 1982, p.107).

The researchers also conducted a group interview with 2 female SME owners and 1 male SME owner to have an insight (Boddy, 2005) of the perceptions of the SME owners on the barriers to formalisation and the motivation for being formalised. The objective of the group interview was to identify and understand how the group of participants responds to the questions posed by the researcher (Gibbs, 1997).

The list of the interviewees and their codes are given below:

Table 17: List of Interviewee with Codes

Interviewee	Organisation	Coding	Data Collection Method
Professor	University of Dhaka	AC001	In-depth Interview
Professor	University of Dhaka	AC002	In-depth Interview
President/Member	NASCIB	AP001	In-depth Interview
President/Member	PWCCI	AP002	In-depth Interview
Director	CPD	PM008	In-depth Interview
SME Development Specialist	ILO	PM001	In-depth Interview and FGD
Professor	University of Dhaka	AC003	FGD
Joint Director	Bangladesh Bank	PM002	FGD
Managing Director	SME Foundation	PM003	FGD
Head of SME Banking	BRAC Bank Limited	PM004	FGD
Deputy Secretary	Ministry of Industries	PM005	FGD
Chief Coordinator	Prothom Alo	PM006	FGD
Manager	UCEP	PM007	FGD
Formal SME Owner	Retail	FE001	FGD
Formal SME Owner	Retail	FE004	FGD
Formal SME Owner	Retail	FE005	FGD
Formal SME Owner	Photocopy	FE006	FGD
Formal SME Owner	IT Business	FE007	FGD
Formal SME Owner	Retail	FE008	FGD
Formal SME Owner	Consultancy	FE009	FGD
Formal SME Owner	Souvenirs	FE010	FGD
Informal SME Owner	Retail	IE002	FGD
Informal SME Owner	Retail	IE003	FGD
Informal SME Owner	Travel Agency	IE004	FGD
Informal SME Owner	Stationary	IE005	FGD

The interviews were conducted in two stages: (1) pilot study (2) main interviews. The objective of the pilot study was to test whether the questions in the interview protocol could result in responses of pertinence to the research objectives (King, 1994). Interview participants were selected through snowball sampling and also through research on the experts on SME development in Bangladesh. Besides, after the FGD was conducted, some participants of the FGD were contacted further for in-depth conversation about the issue of formalisation of SMEs. At the same time, the importance of acquiring participants who will be willing to share information openly and honestly or “their story” (Creswall, 2007, p. 133) was emphasised on. The number of interviews were determined by the concept of data saturation, which is the point at which data gathered in subsequent interviews no longer produces new thematic insights (Guest, Bunce, and Johnson, 2006).

An interview guide was used to focus upon issues and themes central to this research and to ensure consistency of questions between interviews (Appendix A4-A6). It helped the researcher ensure that the same information was obtained with the basic themes identified. It also helped the systematic and comprehensive collections of issues/ themes across a number of interviews (O’ Dwyer, 2000). Knowledge gathered from contextual analysis, literature review of informal SMEs, SME development, challenges of formalisation process, etc., and pilot interview(s) prior to the main interviews, were drawn on in designing the interview guide. Most of the interviews were conducted face to face at the place of the interviewee; some were conducted online through Microsoft Zoom platform. The researcher ensured conducting the interviews with participants in a comfortable environment where the participants do not feel restricted or uncomfortable to share information.

| Qualitative Data Analysis |

The qualitative data collected from the 2 FGDs and 9 interviews were transcribed and translated when the language was native (Bengali). The transcriptions of the in-depth semi structured interviews and FGDs were read again and again and coded by the researchers independently and finally recurrent themes were identified. The interview transcripts were subject to several rounds of reading. The purpose of the first round of reading was to capture the overall message from the interviews, the interview transcripts were analysed using three sub processes: 1) data reduction 2) data display and 3) conclusion drawing (Miles and Huberman, 1994; Miles, Huberman and Saldana, 2013; O’Dwyer, 2004).

Data reduction, conducted during the first round of reading, includes the process of selecting, focusing and simplifying the data from the transcripts. Data display involves organising and assembling the excerpts from the transcripts to support the analysis and conclusion/verification. Two overarching themes were identified at the initial stage:

- **Motivations for formalisation**
- **Barriers to formalisation**

The table on the next page elaborates on the different concepts that were categorised under these two themes based on the two sets of stakeholders, i.e., informal SME owners and other stakeholders including but not limited to research and academic institutes, associations, etc.

Table 18: Themes from Qualitative Data Collection

Overarching Themes	Informal SME Owners	Other Stakeholders
Motivations for Formalisations	Growth	Financial Inclusion
	Market Access	Competitiveness in the Global Market
	Access to Finance	Labour Employment
	Recognition and Awards	Stabilise Income Volatility
	Stability	Growth and Development
	Government Incentives and Stimuli	Tax Revenue
		Compliance to Global Standards (SDG Goals, ILO Convention 2016)
Barriers to Formalisation	Fear of Uncertainty	Lower Competitiveness
	Freedom of Choice	Lack of Database
	Social and Family norms	Policy Gaps
	Financial Hurdles	Uniform Definition of SME and Informality
	Resistance to Operational Changes	Institutional and Regulatory Environment
	Awareness	Integrated Effort and Framework for SME Development
	Benefit Vs. Risk Assessment	Integrated Effort and Framework for SME Development
	Lack of Financial Incentives	Lower Enforcement by Supply Chain Governance
	Documentation Hurdles	Growth Oriented SMEs

| Ethical Considerations of the Research |

The participants in surveys, interviews and FGDs were informed about the objectives of the research and consent was taken for them. The surveys were anonymous. The researchers ensured the anonymity of the participants and confidentiality of the information provided by the participants through coding the names of the interviewees.

A photograph of a narrow alleyway between brick buildings. A group of women, mostly wearing headscarves and colorful saris, are sitting on the ground, processing long strands of jute. One woman stands in the background, looking towards the camera. The scene is overlaid with a semi-transparent white filter.

Chapter 5

Quantitative Findings

5.1. Introduction to Quantitative Findings

This chapter presents the quantitative results and findings of the survey conducted. The objective of the survey was to find out what motivates informal SMEs to formalise and their perceptions of the hurdles they consider while formalising.

| Descriptive Statistics |

Table 19 presents the percentage of respondents from the survey who are motivated to formalise their informal SMEs. It shows that 74% (226 out of 304) informal SMEs are motivated to formalise their businesses considering the factors, but 26% (78 out of 304) informal SME owners are not interested in formalising their business. 86% (260 out of 304) people are motivated to formalise their businesses if a low level of interest rate (IR) is offered on bank loans after they formalise, while 88% (266 out of 304) respondents are willing to formalise the business if flexible collateral requirement (COLL) is provided. 77% (233 out of 304) of informal SMEs in the survey responded that they would tend to formalise their business as they are aware of the formalisation benefits (AWRNS).

Table 19: Descriptive Statistics

Variables	N	Motivated to formalise	
		Yes	No
FML	304	74%	26%
IR	304	86%	14%
COLL	304	88%	13%
AWRNS	304	77%	23%
OneStop	304	89%	11%
REG	304	83%	17%
TECH	304	86%	14%
Fin_Govt.	304	88%	12%
TNG	304	92%	8%

Source: Authors' calculation based on survey data

Note: All responses are rounded to the nearest whole number.

The average sales value is BDT 330,141.45, which ranges between BDT 5,000 and BDT 2,200,000. The average year of operation is 9 years. Finally, the average number of employees is 7, which varies from 0 (Nohoua, 2021) to 45.

Reliability of Survey Instrument

Table 20: Reliability of Survey Instrument

	Motivating Factors	Challenging Factors	Demographic Factors
Cronbach's Alpha	0.783	0.847	0.503

Source: Output estimated by IBM SPSS Statistics

For measuring the reliability test of the model, we have considered the value of Cronbach's alpha (α) (Khalil et al., 2022). Using Cronbach's alpha (α), the internal consistency of questions set in the questionnaire can be calculated. To establish the reliability, Cronbach's alpha should be at least 0.70 (Sulaiman et al., 2020). According to Table 20, except for the demographic factors, Cronbach's alpha scores of motivating and challenging factors were reliable as those values are more significant than 0.70.

Multicollinearity Analysis

Table 21 presents the correlation matrix between the independent variables calculated by the help of Pearson correlation. A high degree of correlation among independent variables is not expected in regression analysis as it weakens the strength of independent variables' interpretation (Uddin, 2019). According to Lind, Marchal and Wathen (2012), if the correlation between two independent variables is between 0.70 and -0.70, it is likely that there is no problem using both of the independent variables. The independent variables were coded with B1 to B8 in the following table. . Table 21 shows no multicollinearity problem among the independent variables, as correlation values for all the independent variables are within the accepted limit. The highest correlation value is 0.664 between low interest rate and collateral requirement, which is lower than the acceptable limit.

Table 21: Pearson Correlation Matrix

	B1	B2	B3	B4	B5	B6	B7	B8	Log_sales	AGE	EE
B1	1										
B2	0.664	1									
B3	0.325	0.356	1								
B4	0.407	0.324	0.368	1							
B5	0.241	0.283	0.418	0.248	1						
B6	0.283	0.297	0.458	0.255	0.491	1					
B7	0.203	0.238	0.239	0.246	0.307	0.379	1				
B8	0.157	0.258	0.242	0.218	0.391	0.261	0.429	1			
Log_sales	0.127	0.123	0.234	0.146	0.31	0.247	0.245	0.193	1		
AGE	-0.033	-0.064	-0.058	-0.101	0.04	-0.086	-0.004	0.022	-0.017	1	
EE	0.01	0.046	0.079	-0.025	0.242	0.204	0.177	0.183	0.267	0.18	1

Source: Output estimated by IBM SPSS Statistics

5.2. Challenges faced by Informal SMEs in becoming Formal

To investigate the challenges informal SMEs face in becoming formal, seven questions have been asked on different challenges that may arise if they wish to be formal. Responses have been considered on a Five-point Likert scale measurement. Table 22, presented below, summarises their responses regarding different challenges. 57% of respondents agree that providing tax will be burdensome for them as, in their current condition, they don't have to provide any tax. In Bangladesh, one formal business needs to take a trade license from proper authority by providing some fees. Also, this trade license needs to be renewed yearly by providing some fees. 51% of respondents agree that the fees associated with making a trade license and renewing it are burdensome for them, whereas 27% of respondents strongly agree with this fact. 54% of respondents agree with the fact that it will be difficult for them to renew their trade license every year.

Table 22: Challenges faced by Informal SMEs in becoming Formal

	Strongly Disagree	Disagree	Neither Agree nor Disagree	Agree	Strongly Agree
Tax Burden	6%	12%	7%	57%	19%
Cost of Trade license	5%	9%	7%	51%	27%
Renewal of Trade license	8%	10%	3%	54%	26%
Penalty for Failing to Pay Taxes	5%	11%	9%	55%	20%
Govt. Rules and Regulation	7%	17%	16%	44%	17%
Proper Documentations	4%	15%	17%	46%	18%
Knowledge Requirement	4%	18%	13%	49%	15%

Source: Authors' own calculation based on survey data

Note: All responses are rounded to the nearest whole number

⁵ Note: B1 = IR; B2 = COLL; B3 = AWRNS; B4 = OneStop; B5 = REG; B6 = TECH; B7 = Fin_Govt.; B8 = TNG

Also, a question was asked regarding their perception of facing a penalty if they become formal but do not provide tax. It is usual that if businesses do not pay taxes on time, they face some penalties. 55% of people agree that the imposition of penalties will be burdensome for them if they become formal but do not provide tax to the government, and 20% of people strongly agree with this fact. Moreover, after becoming formal, some regulations need to be obliged by the businesses such as fire safety, regulations related to employment and workplace, etc. 44% respondents consider this fact as troublesome for them as they don't have to follow such regulations in their current condition.

Formal businesses need to maintain proper documentation about their sales, cost, profit, etc. Maintaining this documentation on a regular basis is considered as troublesome by 46% respondents of the survey. Lastly, we consider the fact that, becoming formal and continuing business in formal form require some knowledge on formal business operation, maintenance of accounts, etc. 49% respondents agree with the fact that this is challenging for them to acquire such knowledge whereas 15% strongly agree with this fact.

5.3. Motivational Determinants for Informal SMEs to Formalise

We conducted logit regression models to explore the motivational factors influencing informal SMEs in transitioning to formal. Table 23 represents the results based on the logit models. The 2nd column shows the results for the total sample. Number of employees is a significant determinant of firm size (Calof, 1994; Dang, Li, and Yang, 2018) and therefore we divided the total sample in two sub-groups based on the number of employees assuming the fact that higher number of employees indicate larger firm size and firm size might affect the motivation for being formalised. Hence, the 3rd column shows the Model 2 results where informal SMEs with more than 5 employees have been considered. The 4th column includes the result of informal SMEs with employees up to 5. Finally, Model 4 presents the result for informal SMEs based on male ownership.

Table 23: Logistic Model for the Factors motivating Informal SMEs to formalise the business

Variables	Model 1 (All Sample)		Model 2 (More than 5 employees)		Model 3 (Up to 5 employees)		Model 4 (Male Owner)	
	Coefficient (Std. Err.)	Odds Ratio	Coefficient (Std. Err.)	Odds Ratio	Coefficient (Std. Err.)	Odds Ratio	Coefficient (Std. Err.)	Odds Ratio
IR	-0.021 (-0.538)	0.979	-0.271 (-0.934)	0.762	0.478 (-0.726)	1.61 3	0.026 (0.588)	1.026
COLL	1.276* (-0.576)	3.583	1.300 (-1.139)	3.67	1.697* (-0.859)	5.45 9	0.736 (0.674)	2.087
AWRNS	0.335 (-0.399)	1.398	0.081 (-0.589)	1.084	1.224* (-0.701)	3.40 1	0.514 (0.449)	1.671
OneStop	1.014* (-0.478)	2.758	1.551* (-0.805)	4.714	0.139 (-0.741)	1.14 9	1.499* (0.596)	4.475
REG	0.481 (-0.462)	1.617	0.133 (-0.689)	1.142	-0.059 (-0.366)	0.94 3	0.643 (0.547)	1.902
TECH	-1.243* (-0.561)	0.288	-0.686 (-1.133)	0.503	-0.366 (-0.893)	0.69 3	-1.869* (0.762)	0.154
Fin_Govt.	1.414** (-0.508)	4.111	3.625** (-1.227)	37.53 6	0.816 (-0.746)	2.26 1	1.466* (0.582)	4.333
TNG	-0.911 (-0.655)	0.402	-0.651 (-2.276)	0.521	-0.534 (-0.918)	0.58 6	-0.556 (0.799)	0.574
Log_sales	0.763*** (-0.159)	2.145	0.908*** (-0.226)	2.480	1.245** (-0.405)	3.47 2	0.852*** (0.185)	2.345
AGE	-0.001 (-0.012)	0.999	-0.014 (-0.012)	0.986	0.067 (-0.047)	1.07	0.043 (0.027)	1.044
EE	-0.054* (-0.027)	0.947	0.014 (-0.045)	1.014	-0.388* (-0.218)	0.67 9	-0.049 (0.033)	0.952
Constant	-9.396*** (-1.841)	0.000	14.469** * (-3.586)	0.000	14.751** * (-4.761)	0.00 0	-10.84*** (2.203)	0.000
N	304		201		103		264	
Pseudo R Square	0.321		0.388		0.396		0.352	

Source: Output estimated by IBM SPSS Statistics

Note: ***P<0.01%; **P<1% and *P<10% indicate statistical significance level

The results indicate that, collateral requirement (COLL) ($b=1.276$, $p<10\%$) and one-stop regulatory system (OneStop) ($b=1.014$, $p<10\%$) are found to be positively significant indicating that an informal SME owner is 3.583 times more likely to be motivated to formalise due to an improvement in the collateral requirement (COLL) and 2.758 times more likely to be motivated to formalise because of the introduction of one-stop regulatory system (OneStop) compared with one who is not motivated to formalise the informal SMEs. The statistical significance of these variables shows the importance of access to finance and simplification of the formalisation process as a motivating factor for formalisation.

Adoption of technology by employees (TECH) ($b= -1.243$, $p<10\%$) is found to be negatively significant, reflecting that as the employees tend to adopt to technology, the likelihood of motivation to formalise decreases considerably to 0.288, keeping other variables constant. Possible explanation might be, since formalisation requires usage of technology such as digital literacy to some extent, it might work as demotivating factors for them to become formalised. Total employee (EE) ($b= -0.054$, $p<10\%$) is also found to be negatively significant reflecting that the odds of being motivated to formalise informal SMEs decreases to 0.947 in comparison with those who are not motivated to formalise. One possible reason could be that when an informal firm becomes registered, it has to follow several employment laws and labour standards in terms of minimum wages and labour laws. But when it operates under a shadow economy, the owner is not answerable to anyone for the treatment of employees. This explanation indicates that total employee (EE) reduces the probability of motivation to formalise the informal SMEs.

Financial support from the government (Fin_Govt.) ($b=1.414$, $p<1\%$), sales (Log_sales) ($b=0.763$, $p<0.01\%$) are positively significantly associated with the likelihood of motivation to formalise their informal business. The control variable sales is found to be positively significant for all the models of SMEs in determining their willingness to formalise their business consistent with the result of Zylfijaj et al. (2020). If this variable increases by one unit, the probability of motivation to formalise increases to 2.145. These findings indicate that increased sales of the business are linked with business growth (Le Meunier-FitzHugh and Piercy, 2007) and this growth motivates the owners of informal businesses to formalise their businesses. The results also indicate that financial support from government (Fin_Govt.) ($b=1.414$, $p<1\%$) to informal businesses in order to be formal are important motivational factor for informal business owners.

This is consistent with previous literature of Nguyen et al. (2014). With other variables held constant, an informal SME owner is 4.111 times more likely to be motivated to formalise if he gets financial support from the government than the informal business owner with no financial support from the government. As becoming formal and continuing business in formal form are associated with some costs, getting some sort of incentives from the government is useful in determining owners' willingness to formalise their businesses.

Moreover, collateral requirement (COLL) is significant for model 3 representing 5 or less employees but not significant for model 2 representing employees more than 5. The possible reason might be firms with employees 5 or less than 5 don't have enough strength to provide collateral and therefore consider getting financing from banks without collateral as an important motivational factor for becoming formal. On the other hand, firms with more than 5 employees are comparatively larger in size and might have ability to provide collateral and therefore do not consider this fact as important.

Now, the variable awareness of the formalisation benefits (AWRNS) ($b = 1.224$, $p < 10\%$) is positively significant for model 3 with employees up to 5, reflecting that informal SMEs with employees up to 5 are 3.401 times more likely to be motivated to formalise than informal SMEs with employees more than 5. It could be possible that since these are very small informal firms and if they enter into the registration process, they might enjoy the benefits associated with formalisation just like the large firms are enjoying.

Lastly, the Pseudo R square value for total sample under model 1 indicates that at least one of the variables in the equation explains 32.10% variability in the dependent variable motivation to formalise (Moazz and Mansour, 2023).

A photograph of a group of women sitting on the ground in a narrow alleyway between brick buildings, weaving baskets from straw. One woman stands in the background. The scene is overlaid with a semi-transparent white filter.

Chapter 6

Qualitative Findings

6.1. Introduction to Qualitative Findings

This chapter presents the qualitative findings of the In-Depth Interviews and FGDs. The objective of this chapter is to explore the motivations to formalise the informal enterprises from the SME owners' perspectives and from the policymakers/regulators and other stakeholders' perspective. The findings are organised under the recurring themes identified in the data analysis of the interviews and FGDs.

Formalisation is inevitable, however, there needs to be a comprehensive framework and policies and implementation strategies with a timeline for the formalisation process. A number of factors have been highlighted by the respondents in the FGDs which was further discussed with selective interviewees. Based on the emerging themes identified by the researchers, the following sections contain the findings.

6.2. Motivation of SMEs to Formalise: SME Owners' Perspectives

Growth Orientation

Business Growth has been identified as a critical motivation to formalise by a number of participants in the FGDs as well as in the in-depth interviews. Informal SMEs are usually small with low productivity and efficiency and many SMEs have a very short life span as they cannot reach the growth stage (Hulbert, Gilmore, and Carson 2013). SMEs who want to expand their business consider formalisation. One SME entrepreneur in the retail business who started off informal was not sure of whether the business would do well and was sceptical to undergo the bureaucratic process of transitioning to formal enterprise. Once he was confident of the business himself, he conducted all the paperwork for formalisation.

"When I became confident, I wanted to expand my business and went for all paperwork.... This depends on individual's goals on where you want to see your business in next five years..." (FE004)

Even SME experts have highlighted the importance of growth-oriented SMEs to be formalised. During the interview, a representative from one of the Development Organisations also pointed out why all small enterprises are not being formalised. This is consistent with the understanding that the opportunity entrepreneurs should be motivated to formalise while survivalist entrepreneurs should not be formalised. Only the enterprises who are growth oriented should be targeted for formalisation. One respondent from the FGD emphasised:

"It is better to have 10 large enterprises at the end rather than 100 subsistence enterprises." (PM001)

| Access to Market |

Many formal business relationships, such as contracts with larger companies or foreign companies or participation in government procurement programs, may require formal business status. Formalisation can open up opportunities for informal enterprises to enter new markets and establish partnerships with other formal businesses. Access to the market for the goods and services has come up as a crucial factor as motivation for formalisation. Interviewees mentioned that small enterprises do not get the chance to display their products domestically or internationally. Even the small enterprises can participate in government procurement programs. One female entrepreneur who supplies online grocery to consumers highlighted the greater access to market she is getting after being formal:

"..Now we are enjoying the facilities of being formal as a SME. When we go to the SME fairs....we display our products and we have market accessibility....." (FE001)

A small enterprise manufacturing Bangladeshi souvenir explained how he has been able to acquire large clients once he went formal:

"But when I compared the facilities in informal v/s formal, I saw that being formal gives me higher facilities because as an organisation, there is no other way to execute the big orders, other than being formal." (FE010)

Another participant, who owns a management consultancy firm, started off informal and has formalised his business with all proper documentation highlighted:

"...when we work with corporate houses, they make it mandatory to have the list of updated papers. When we submit any quotation or proposal to the World Bank, then we have to submit these papers. When we submit any foreign research project, or commercial research, we have to submit these papers..." (FE009) He further added, *"When we go to any place and people see us as a limited company, our acceptance increases." (FE009)*

While discussing the greater access to market, the participants emphasised the poor infrastructure and unavailability of market as a constraint for the informal enterprises. Even the institutions responsible for developing SMEs also emphasized this issue.

"Where is the market for informal SMEs? Do we have any facilities for the informal sectors? Recently, Oikko.com has started an informal holiday market in Bangladesh. This is, I think, the first in the country. Other than this, we do not have any formal marketing channels for informal SMEs." (PM003)

| Access to Capital |

One of the primary reasons for formalisation is the improved access to financial services. Formal businesses can access loans, credit lines, and other financial resources that are often unavailable or limited for informal enterprises. This access to capital can enable business expansion and investment in growth opportunities. Almost all participants in the FGD cited Access to Finance/ Capital as a motivation for formalisation. At the same time, the issue of collateral free loans came up, which is consistent with the survey findings as well. Absence of trade license does not allow them to have a merchant account of MFS which hinders their business.

One participant mentioned:

"After I got the trade license, BRAC supported me with some money. Because I have the license, the bank gave me loans. If I did not have the license, then banks would never help me." (FE006)

Another entrepreneur cited an example:

"One local bank is focusing a lot on SMEs. They are approaching small or medium business owners to give loans. They offered me a 4 crore TK loan at 4% rate and said that even if I don't use this money, I could do a fixed deposit at 6% so that I get a 2% yearly benefit. So, offers like this come if you have a trade license or a business account." (FE007)

Access to Support, Networks, Associations, and Recognition

Formal businesses can join industry associations, chambers of commerce, and networking groups. These connections can lead to valuable business contacts, information sharing, and collective advocacy. All the NASCIB members have trade licenses and NASCIB supports the small enterprises to apply for trade license and registration online. In the FGDs conducted, the informal enterprises all participants mentioned the need for formalisation as a prerequisite for recognition and awards.

Governments often provide support, incentives, and subsidies to formal businesses, including training programs, grants, and tax benefits. This support can be a compelling reason for informal enterprises to formalise. During the COVID-19, the informal business did not get any kind of support from the Government since they were not registered. A number of them had to close their businesses.

6.3. Motivation of SMEs to Formalise: Stakeholders' Perspectives

While the informal enterprises have their own motivations to transition to formalisation, a number of motivating factors were identified from the other stakeholders' perspective as well:

| Economic Growth and Development |

From the country's perspective, growth and development was considered as a motivating factor to formalise in the FGD and interview. As businesses grow and expand, they tend to create more jobs, reducing unemployment rates and poverty. Increased employment can also lead to improved job quality, including legal protections, benefits and social security. At the same time, adoption of technology can be provided and productivity will rise leading to higher contribution to GDP.

A renowned economist and researcher on SME illuminated the need for formalisation from economic development point of view:

"If we think from the development perspective, it provides stability to people, income of the people is brought into a support system, motivates to generate employment opportunities. If this welfare development is our objective, then we will go for formalisation." (AC001)

| Increasing Tax Revenue |

The FGD discussion revealed that one of the primary motivations of the government to formalise is to broaden the tax base and increase tax revenue. Informal enterprises often operate outside the tax system, leading to revenue losses for governments. Formalisation allows governments to collect taxes, such as income tax, value-added tax (VAT), and business licensing fees, which can be used to fund public services and infrastructure development.

The official from Ministry of Industries mentioned in the FGD that,

"If we could make the informal economy a formalised one, we could earn a huge amount of revenue that would also help the government to run the mission." (PM005)

It also came out during discussion with another eminent economist that currently the government is not even getting Value Added Tax (VAT) properly and the enterprises are not getting the VAT rebate benefits. VAT has to be given by every value chain partner in the value chain, otherwise; rebate cannot be claimed. However, since some of the value chain partners in almost every sector/ industry are informal, even the formal enterprises cannot claim the rebate and eventually the consumers end up paying sales tax.

| Financial Inclusion |

Inclusiveness and Financial Inclusion have been highlighted as one of the factors of motivations of formalisation for the government. Informal SMEs usually operate outside the formal financial system, which limits their access to credit, insurance, and other financial services.

Formalisation can help bridge this gap by bringing these businesses into the formal economy. In an interview with a policy advocate, he explained how formalisation of the informal sector will ensure financial inclusiveness of the micro and small companies and provide data for the government to have a proper overview of the sector, their contribution, market share which would be beneficial for the policymakers to formulate policies.

■ Compliance to Global Standards ■

As per the ILO Convention 2016, the government has agreed to bring in the informal sector under formalisation. However, as mentioned by the SME specialist at ILO, formalisation takes place in two ways: (1) Enterprise formalisation and (2) Employment formalisation. In order to formalise employment, the enterprises will have to be formal. Therefore, there has to be effective pull from the government side to make the small informal enterprises formal. Even from the perspective of a decent job in SDG, formalisation is important.

■ Economic Data ■

Formalisation provides governments with better data and insights into the economy. Accurate economic data is essential for policy planning, resource allocation, and the formulation of effective economic development strategies. The Research Director of the Centre for Policy Dialogue (CPD) explained how formalisation will bring in the small enterprises under one database and will give the government information on the market share, the contribution of the SMEs in the GDP, etc. He added,

*“Once the data is available, we can actually understand the market players, the market share and if there is any market failure.”
(PM008)*

Since, there is no database on the informal enterprises, it is difficult to have an idea of the vastness and diversity of the informal sector, their contribution or their challenges. It is also not possible to bring them into the database.

“Neither the formal SMEs nor the informal ones have any census. The census at BBS is outdated which does not mean anything now. What we very much need now is a census of SMEs, both formal and informal- how many enterprises are there, what are their conditions, etc.” (PM004)

The above themes for motivations of small informal enterprises emerged while coding the interviews and FGD. The next section discussed the barriers/hurdles to formalisation that were revealed during the interview and the FGDs.

6.4. Hurdles to Formalisation

Cumbersome Formalisation Process

The biggest hurdles that almost every respondent in both FGDs and Interviews pointed out was the cumbersome formalisation process; namely the registration or acquiring trade license. Additionally, the trade license needed to be renewed every year, which the government has recently modified. Currently, the trade license needs to be renewed every 5 years. Interesting insights from the experiences of the SME owners revealed that not only the process is cumbersome, but the cost is also an issue for small enterprises.

Initial Formalisation Process

- Step 1: Trade license (for five years)
- Step 2: Register for VAT and TIN Certificate
- Step 3: Open Bank Account
- Step 4: (If the enterprise needs to manufacture), then need to register with Bangladesh Investment Development Authority (BIDA) and get the required permission to produce.

The FGD findings and Interview Findings have unanimously highlighted the difficulty of the formalisation process. The President of the Association for small enterprises mentioned:

"34 license documents are required upon formalisation like fire brigade license, environment license, factory license, etc. that incurs a lot of cost. There are a lot of barriers in formalising. In India, there are only 7 documents, whereas Bangladesh has 34. For manufacturing companies, they need to renew their fire license every year." (AP001)

The policy advocates and SME experts emphasised that unless the process is simplified, the waiting times is reduced or the bureaucracy is resolved, formalisation will be difficult. In fact, one of the interviewees suggested:

"There could be a kind of semi-formal process, may be just a registration number..." (AC002)

The president of NASCIB also suggested that NASCIB members can apply for the enterprises online if there is a simple process.

The entrepreneurs and associations also pointed out discriminatory costs to be an issue. One member of the Association stated during her conversation.

“Trade licenses that are created at zilla (district) level are done by municipalities. Each municipality charges a different amount, and it has rather become a source of income for them.” (AP002)

| Fear of Uncertainty/Adapting to Potential Uncertain Environment |

The fear of paying taxes, including income taxes and value-added taxes (VAT), can be a significant deterrent to formalisation for many businesses. In addition to that, lack of trust in government institutions, including concerns about corruption, may discourage small entrepreneurs from engaging with formalisation processes. Officials of SME Foundation highlighted that:

“If you ask an entrepreneur if he/she would you like to be formalised, he/she would decline citing the pressure from tax /VAT to pay taxes on time, the fear of penalty and fines due to missed deadlines...” (PM003)

Some entrepreneurs may choose to remain informal due to existing perceived advantages, such as avoiding taxes, regulatory oversight, or the ability to operate without strict compliance with labour laws or any other regulations or permission. For instance, it happens that the small entrepreneurs sometimes use illegal electricity lines for their business which they cannot do once they formalise.

“Currently, they don’t have to do anything besides managing few local ‘mastans’.” (PM006)

This fear is even higher for women entrepreneurs. When the women entrepreneurs know that they have to pay some fees every year and have to give a business address, they get scared and feel at ease to do their business online.

| One female entrepreneur in her interview mentioned that, |

“We fear the hassle associated with yearly fees and banks. I personally am scared of banks for this.” (FE004)

In terms of adopting technology, women entrepreneurs feel some fear, discomfort, and reluctance which hinders the formalisation motives. For instance, while using a MFS app like bKash or Nagad, there's a sense of apprehension or hesitation when it comes to confirming the payment.

| Freedom and Adaptability |

The owners of the small enterprises are sceptical about formalisation because they are currently free to enter their business and can exit

⁶ “Mastans”, a Bengali word to explain rowdy people

whenever they want. In fact, at times, their primary concerns are daily survival and meeting operational expenses, which can take precedence over formalisation efforts. At the same time, they can employ workers as their wish and do not need to comply with any labour standards or regulations. The salaries can be paid in cash; either fixed monthly salaries or on the basis of production rate. They do not need to maintain the labour rights or minimum wages. Shifting from informal to formal operations may require changes in business practices, record-keeping, and compliance with labour and environmental regulations, which can be challenging to implement.

Since most of the transactions are conducted in cash, there is no need to maintain any accounts of their financial transactions. They can hire anyone to work, in fact, in many cases the workers are primarily the family members of the enterprise owner.

In terms of capital, they can make their decisions on access to capital. They can borrow from family and friends or even local cooperatives.

“When you take a loan from a ‘shomiti’ (association/cooperative), you don’t need a trade license, they give you a specific interest rate, you can repay at your own ease, there will be no problem if you are a bit late to repay.” (FE005)

Informal small enterprises can quickly respond to changing market conditions and consumer demands due to their smaller size and flexibility. This adaptability can contribute to economic resilience and competitiveness.

One informal SME owner explained how he shut down his photocopy and stationery shop during COVID and went to his village immediately and started a small dairy farm there.

Benefits VS Cost Assessment

The expenses associated with formalisation, such as registration fees, legal fees, and compliance costs, can be prohibitive for small and micro-enterprises with limited resources. Cost Benefit Assessment was a common hurdle mentioned by the FGD participants. The cost of registration, acquiring trade license and subsequent permissions and the multi layered registration process and eventually the Tax and VAT payments every year is considered a major cost compared to the perceived benefits from being a formal enterprise. One SME owner (a photocopy and stationery shop) mentioned that there is no difference in terms of serving customers whether one has a trade license or not.

“There’s no benefit of formalisation (in serving customers).” (FE006)

Another respondent added,

“In fact, there will be more loss if I have the documentation due to yearly fees.” (IE005)

| Lack of Incentives |

The FGD participants mentioned the lack of incentives to formalise a constraining factor for formalisation of enterprises. Governments can implement a range of incentives and support mechanisms, such as tax breaks for newly formalised businesses, streamlined registration processes, financial assistance programs, and training and capacity-building initiatives.

These incentives should be designed to make formalisation attractive, reduce financial barriers, and provide entrepreneurs with a clear path toward formalisation. Additionally, governments can work on building trust and confidence among informal entrepreneurs by ensuring that promised incentives are delivered consistently and transparently. A number of suggestive measures have been highlighted during the conversation.

The Head of SME of a large local bank cited examples of other countries:

“I study about SMEs in other countries, and I have seen that Malaysia and Indonesia have given tax holidays to informal SMEs for 5 years so that they can grow. In India, businesses earning up to 65 lakh+ rupees in turnover do not have to worry about tax.” (PM004)

Another economist, academic, and researcher in SME mentioned,

“Those who have very small businesses can be incentivised for instance, a tax exemption for a few years in if the taxable income and revenue falls below a threshold.” (AC001)

| Lack of Awareness |

During the conversation in both FGDs as well as interviews, the government’s lack of efforts in terms of raising awareness of the benefits of formalisation is a challenge for formalisation. Informal entrepreneurs do not fully understand the benefits of formalisation or be aware of the incentives available to them. Effective awareness campaigns and outreach efforts are essential to inform them about the advantages of formalisation.

Participants of FGD shared their experiences of the lack of awareness during the conservation:

"I am trying to get a trade license but I don't know how to do it (trade license) or where to do it." (FE006)

An entrepreneur who has been through the entire process of formalisation shared her experience:

"There was no one to provide us with clear guidance on how much to pay, when to pay, why to pay, where to pay. We wanted to pay online, but some people from the VAT office said that no, you have to come here and pay through our people." (FE001)

| Policy Gaps |

There has not been any focus on the policies, laws, or regulations on the entire informal economy, let alone informal enterprises. The existing key policies like SME Development Policy 2019 or the Industrial policy 2022 do not have anything significant on informal enterprises. Only one chapter in the Industrial Policy 2022 is dedicated to the informal sector. The ambiguity in the policy of both formal and informal SMEs has been identified as a hurdle to the formalisation process. Almost all participants in the FGD have pointed out the issues with the definition of SME and formal vs. informal. The absence of separate policies for small, micro, and medium enterprises was also cited as a challenge for the formalisation of informal small enterprises since they were not aware of the benefits post formalisation. At the same time, there were remarks on the lack of policy for informal enterprises since there is no data of informal enterprises.

"Concerns and challenges for micro and cottages will be different from concerns for medium and policy should be made by considering this." (AC001)

The head of SME in a local private bank mentioned the ambiguity of the definition during loan disbursement to formal SMEs and highlighted the contradiction between the ministry and the central bank regulations:

"Our definition is quite wide. We define SMEs as services, manufacturing and trading...it's like putting all the eggs there... Trading includes a number of activities like pure traders, who work business-to-business, then there is a large portion comprised of both formal and informal sectors- retailers. We do not have any definition for retailers. We put everything under trading and as per government policies, trading is a discouraged sector." (PM004)

While discussing this issue, the president of NASCIB mentioned,

"A census, definition (of formal and informal SMEs), and the tax law need to be looked at." (PM004)

| Social Barriers |

One specific theme recurred during data analysis from the FGD and Interviews which is specific to women owned informal enterprises, namely social norms and barriers. Social norms can limit women's opportunities for networking and mentorship, which are crucial for business success. If women are excluded from male-dominated business circles or are discouraged from pursuing business-related activities, they may not have access to the guidance and support needed to formalise their enterprises. One female entrepreneur's comment on this was:

"It is difficult for a woman to go out of home, let alone go to create a trade license document." (AP002)

Another female SME owner mentioned:

"Women do not want to expand the business to a great extent. To expand, they need to go out, they won't get permission from their husbands." (AP002)

Since informal businesses often operate within tight-knit communities where informal norms and networks play a significant role, they do not go out and gather information on business.

Another interesting perspective of social barrier was reflected from the conversation of the female SME owners in the FGD. The trade license and business including the loan is taken in the name of women since there are women centric loans, however, the husband, at many times, use the loan and runs the business

The female entrepreneurs in the FGD also mentioned how, in societies with deeply ingrained traditional gender roles, women are often expected to play specific roles in the family and community, such as caregivers and homemakers. When women choose to become entrepreneurs, they may face resistance and criticism from their communities, which can deter them from growing, thus hindering formalising their businesses. While sharing their personal lived experiences, one such women entrepreneurs mentioned:

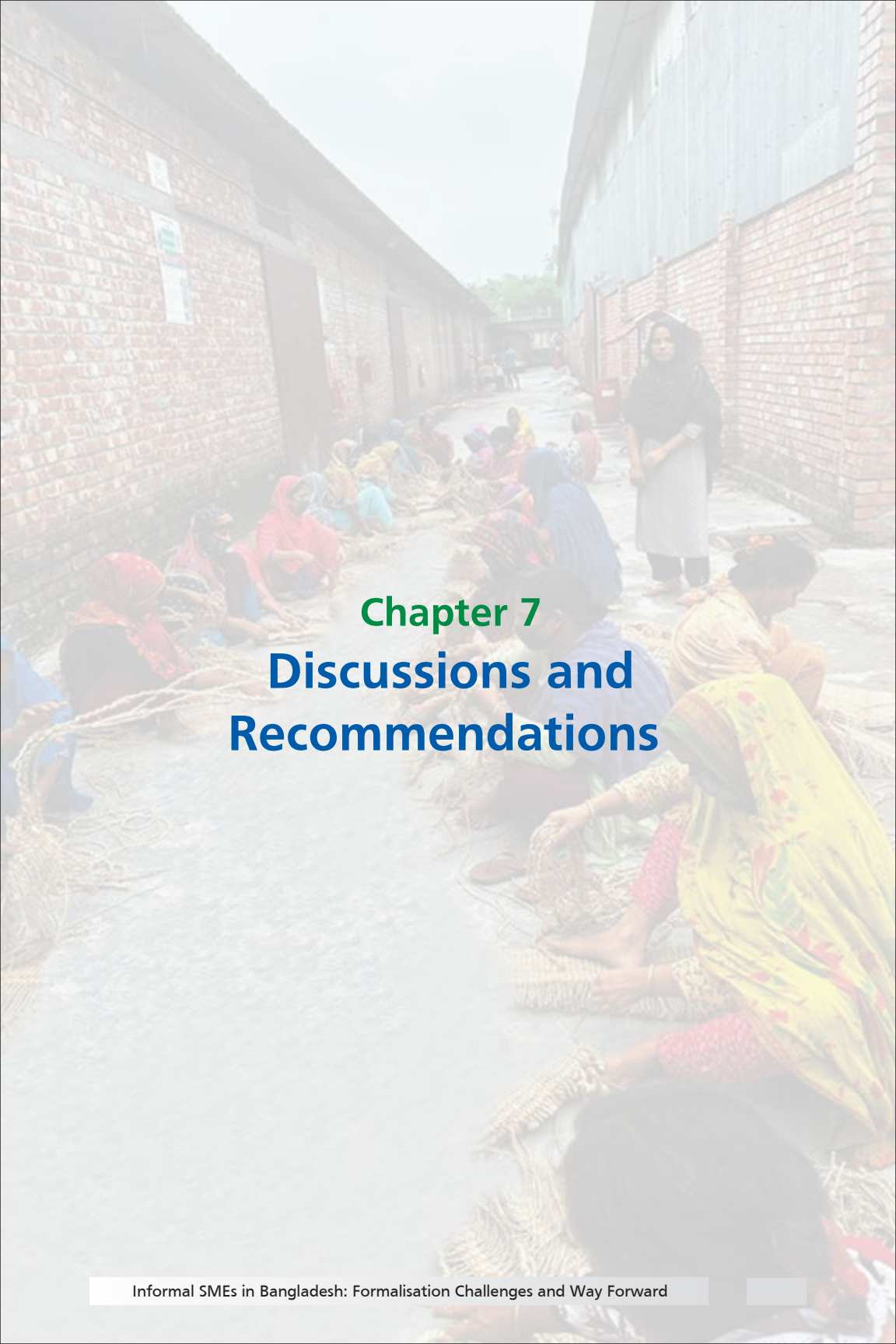
"...They do not consider us as businesswomen. They think that we are just doing business (having no qualifications)... (FE005)

Another women SME owner further added,

“...When I told my mother about my business, she resisted saying that we are a “Dhakaiyya”⁷ (from the old part of Dhaka city) family, so we don’t like it if the girls go out to work..(FE004)

The above themes emerged from the discussion in the FGDs, and the in-depth interviews conducted for this study.

⁷ Usually the females in the old part of Dhaka are conservative.

A photograph of a group of women in a narrow alleyway between brick buildings. They are sitting on the ground, processing long strands of straw or rope. One woman stands in the background, wearing a black headscarf and a grey dress. The scene is overlaid with a semi-transparent white filter.

Chapter 7

Discussions and Recommendations

7.1. Discussion

This chapter discusses and interprets the quantitative and qualitative results and findings and presents the recommendations and action plans for formalising the informal SMEs. The quantitative survey investigated the motivations and challenges of the SME owners. *The qualitative interviews and FGDs were analysed under two overarching themes: (1) motivations of the SMEs and the Government to formalise the informal enterprises and (2) hurdles to formalise from both the SME owners’ and stakeholders’ perspectives.*

There have been a number of common factors identified in both methodologies. The figure below displays the findings from both qualitative and quantitative part:

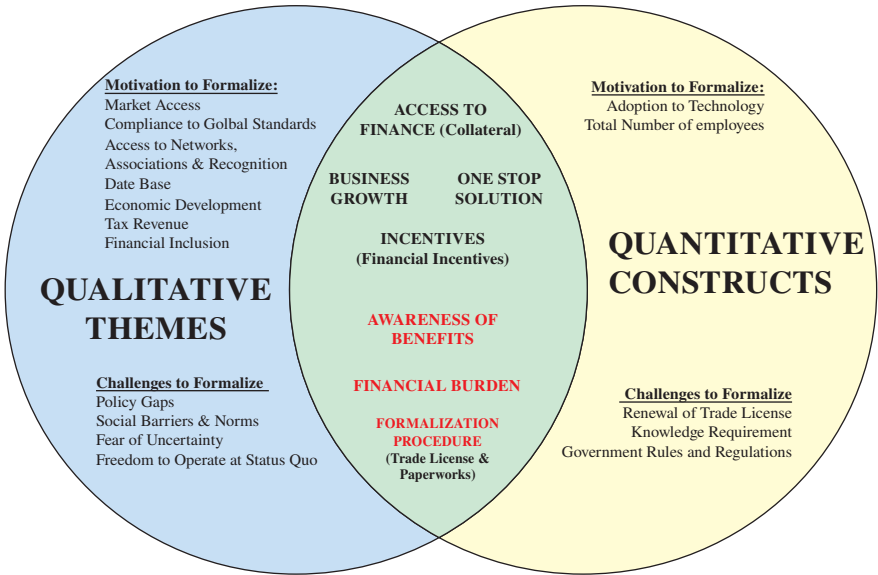


Figure 11: Motivations and Challenges for Formalisation of Informal SMEs

Source: Prepared by the Authors

The figure above presents the factors identified for formalisation from both quantitative survey and qualitative interviews and FGDs. Some common factors have been identified, which was found to be significantly associated with the probability of motivating the informal SMEs in the logistic regression and also during the interviews. However, there were additional factors (as mentioned in the figure above) was revealed during the in-depth FGD Discussion and In-Depth Interviews.

While the registration process/ formalisation process is considered to be the primary hurdle for informal SMEs to formalise, a number of other challenges and suggestions to overcome those challenges were revealed

from the findings. Awareness of the Benefits of Formalisation and the Lack of Incentives (Financial / Non-Financial) were cited by the participants repeatedly.

The complexity and ambiguity of the current policies were highlighted as hurdles during the FGD with the stakeholders. The need for a policy for informal sector, namely small enterprises was reflected in the findings. While the complexity of the registration and formalisation process is the same for men and women in Bangladesh, very interesting insights were revealed in the qualitative findings in the form of social barriers and norms. The challenges are higher and different for women, which might call for further research and policies with gendered lenses.

The authors, while conducting the survey attempted to analyse the data collected from the female owners of SMEs. However, the quantitative data did not reveal any significant data for women owned businesses. This might potentially be due to the fact that when discussed in depth during the interviews and FGDs, women opened up with their issues and challenges. This calls for further research considering the differential impact between gender groups within the Bangladeshi context.

7.2. Recommendations and Way Forward for Formalisation of Informal SMEs

Formalisation is a long and continuous process, and it is only pragmatic to have a comprehensive plan and framework for seamless transitioning to formality. A number of countries in the world, such as Thailand, Vietnam, India, and Singapore, have successfully transitioned the informal enterprises to formal ones and upgraded the SMEs for sustainable development.

While this study has highlighted the challenges of formalisation process in Bangladesh, a number of policy interventions have been identified which can potentially make the transitioning process smooth, some of which are:

1. Develop a comprehensive nationwide formalisation strategy:

The government needs to develop a national formalisation strategy. The government should involve representation and collaboration from stakeholders from both public and private sector and formulate a strategy with **short term, medium term and long term action plans** to formalise the SMEs. The strategy should focus on the policies to be developed and formulated, identification of the roles and responsibilities of different institutions involved in SME development, the activities and programs to be undertaken, the targets to be

achieved, assessment of the programs that help in the transitioning to formalisation, etc. The strategy should not only include the formalisation process but also the **upgradation and safeguarding of the small enterprises** once they are formalised. It is essential for SMEs to upgrade themselves and enhance their operations after formalising. For that, the SMEs will need access to finance and markets, training and development, and incentives for sustainable businesses. The formalisation strategy must incorporate the benefits post formalisation to make it more lucrative more the informal business employees.

2) Plan incremental formalisation process:

While formalisation is inevitable, it is more pragmatic to have an **incremental formalisation process**. In some cases, informal enterprises may consist primarily of survivalist entrepreneurs, operating at subsistence level and selling to low-income consumers in exchange for cash. These enterprises are less receptive to formalisation. Therefore, the government can have a **phase-by-phase planning**; like, the government can target the small enterprises (SEs) with more than 10 employees,⁸ who are not formalised yet, to bring them into formality in the first phase. Alternatively, the government can formalise enterprises cluster-wise. Already, there are clusters of informal SMEs as mentioned in chapter 2 (for instance, Rajshahi has the highest number of handloom and weaving SMEs). Another recommendation is **sector-wise formalisation so that the entire value chain is benefited once formalised**. The Government needs to include the relevant ministries, National Board of Revenue (NBR), etc. to have a collaborative approach to the plan/ process. While phase-by-phase formalisation might be an administrative hassle, however, it provides better planning and effectiveness in terms of monitoring and execution. The incremental formalisation plan should be documented and a **time line** for implementation and monitoring should be there.

3) Simplification of the Formalisation process:

(a) Registration (having a trade license) is the first step towards formalisation. Throughout the business life cycle, compliance with other regulations (Tax, VAT) is essential to follow up the process of formalisation. An unfavourable, overly complicated, and costly business ecosystem might make many micro-enterprises reconsider their decision to be registered. This has been highlighted in the study over and over again by every respondent. Findings suggested

⁸ Since BBS has created the business directory based on number of employees.

that Small enterprises could be given a **pre-registration stage** where they might **avail some of the benefits of formalisation at a simplified process**.

This study identified a number of relevant policy instruments that the policymakers can apply to promote the registration of companies, which go from facilitation through digitalisation to decreasing costs of registration. The following policy instruments can be used:

b) One-stop solution or platform: The government could provide a one-stop solution/platform for registration, access to market, access to finance, renewal and payment of government fees, counselling regarding how to start a business, etc. A number of OECD and ASEAN countries have initiated one-stop online platform, which has been very successful. For example, “MyCo” in Myanmar, ROCBN in Brunei, One Stop Shops in Thailand, and Business One-Stop Shops (BOSS) in Philippines are successful models of one-stop online platforms to register the informal small enterprises. In Bangladesh, BIDA has implemented one-stop solution (OSS) for investors along with other agencies. A similar online platform should be introduced for SMEs where an informal small enterprise can get all the services from registration, tax services, VAT registration and return filing, any certifications needed to conduct business, payment portal to all services, renewals of the licenses, skill development training and permissions, etc. The government should **empower and authorize one agency (for instance, SME Foundation) to implement, execute and monitor the online platform**.

c) Digitisation of the Registration Process: While the one-stop solution/platform can provide support and ease the process of registration, the government can, at the same time, **collaborate with the Mobile Financial Services Companies** (MFS like bKash, Nagad, etc.) and bring the informal enterprises under one single registration number or unique ID. Every MFS registered account has a NID associated with it. The government can collaborate with the MFS Companies and use the same unique number and ID to recognise the registration of the small informal enterprises.

d) Reduction in the Costs of Registration for formalisation: Small enterprises perceive the registration process and the renewal fees as costly, and reducing the costs is perceived as a motivating factor to transitioning to formality. However, in order to ensure efficient services and sustainability of the institutions providing the services,

the costs are necessary. **Digitalisation and One-stop services will automatically reduce the costs of registration** since the regulatory authorities can use the information from one single source. In Malaysia, “MyCoID” platform is used by different agencies for information of the small enterprises, thus reducing time and costs.

4) Incentives for being Formal (Both Financial and Non-Financial Incentives):

The government can offer a wide range of financial and non-financial incentive mechanisms to small enterprises like better access to finance, public procurement or business development services for transitioning to formal enterprises. Formalisation related incentives have proven to be successful in a number of countries around the world (USAID, 2007). In order to encourage them to transition to formal enterprise, government intervention in the form of tax rebates, tax exemption can be given for a specific duration to newly formalised businesses or businesses operating in certain sectors.

The government could also implement a phased/ gradual taxation approach i.e. gradually increasing tax rates over time to ease the transition process of formalisation. However, some limits should ensure that larger companies do not take advantage of it. For example, tax exemption could give a business access to all advantages except the rights to export and to access large public contracts. The Ministry of Industries, NBR, and relevant associations should collaboratively formulate these incentives. While incentives will encourage small enterprises initially, however, enforcement of the policies will be the next step. In addition to this, non-Financial Incentives in the form of training and development in business how to start a business, financial literacy and business acumen, product development and innovations, using technology etc.

Awareness should be created at the divisional and at times at the district level to motivate small enterprises to formalise. Sensitisation of the formalisation benefits should be created to encourage the small enterprises.

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