

Survey Analysis Report of Sources of Informal Economic Activity in Sierra Leone

Part I: Survey Report

June 2006

Foreign Investment Advisory Service
A joint service of the International
Finance Corporation and the World
Bank



Disclaimer

The Organizations (i.e., IBRD and IFC), through FIAS, endeavour, using their best efforts in the time available, to provide high quality services hereunder and have relied on information provided to them by a wide range of other sources. However, they do not make any representations or warranties regarding the completeness or accuracy of the information included in this report, or the results which would be achieved by following its recommendations.

About FIAS

For almost 20 years, FIAS has advised more than 130 member country governments on how to improve their investment climate for both foreign and domestic investors and maximize its impact on poverty reduction. FIAS is a joint service of the International Finance Corporation and the World Bank. We receive funding from these institutions and through contributions from donors and clients.

FIAS also receives core funding from:

Australia	New Zealand
Canada	Norway
Ireland	Sweden
Luxembourg	Switzerland
Netherlands	United Kingdom

Contents

1.	Introduction.....	1
	Background.....	1
	The Economic Context	2
	The Informal Economy	3
2.	Executive Summary.....	8
3.	Survey Results	22
	Characteristics and Structure of the Survey Sample.....	22
	General Characteristics	22
	Informality related characteristics.....	24
	Advantages and Disadvantages of Informality	26
	Advantages of Informality	26
	Disadvantages of Informality.....	29
	Direct Costs of Informality	30
	Reasons for Informality and Government incentives that would stimulate formality	31
	Reasons for Informality	31
	Formalizing completely informal businesses.....	32
	Ex-informal Businesses	36
	Community Leader perceptions.....	37
	Licensing Informality.....	39
	Product Standards Informality	41
	Land Informality	43
	Labor Informality.....	45
	Tax Informality	49
	Reinvestments and loans.....	51
	Reinvested Sales	51
	Loans Applications	51
	General Obstacles for Business Operation	52

List of Figures:

Figure 1. Distribution of Businesses by Activity.....	22
Figure 2. Distribution of Businesses by Size (number of employees).....	23
Figure 3. Years since Formalizing.....	24
Figure 4. Steps through which Businesses Formalized.....	25
Figure 5. Situation of Formal and Informal Businesses.....	27
Figure 6. Reasons behind decision to operate Informally.....	32
Figure 7. Possession of required product standard certificate.....	41
Figure 8. Key reasons for not obtaining product standards certificates.....	42
Figure 9. Ownership rights on land used in business activity.....	43
Figure 10. Reasons to not acquire legal land.....	44
Figure 11. Percentage of workers reported to authorities.....	45
Figure 12. Percentage of workers reported to authorities.....	47
Figure 13. Key reasons for under-reporting salaries to authorities.....	48
Figure 14. Percentage of turnover reported for tax purposes.....	49

List of Tables:

Table 1. GDP growth rates and shares by Sector, 2000-03.....	3
Table 2. Years of Operation.....	19
Table 3. Percentage of unregistered (completely informal) businesses in community.....	21
Table 4. Three most important advantages of being informal.....	24
Table 5. Factors behind main advantage of informality.....	25
Table 6. Three most important disadvantages of being Informal.....	26
Table 7a. Financial costs and other burdens to sustain Informal Status by Level of Operations.....	27
Table 7b. Financial costs and other burdens to sustain informal status by sector.....	27
Table 8. Personal knowledge of about steps to become Formal.....	29
Table 9a. Attempt to formalize by size.....	29
Table 9b. Attempt to formalize by location.....	29
Table 9c. Attempt to formalize by sector.....	29
Table 10. Reasons for failure in attempt to become formal by location.....	30
Table 11. Probability of Formalization over next two years by size of business.....	30
Table 12. Reasons for seriously considering becoming formal by level of operation.....	31
Table 13. Incentives that would increase chances for becoming formal by sector.....	31
Table 14. Businesses operating informally before formalizing by sector.....	32

Table 15a. Reasons for stimulating ex-informal businesses to formality by size	33
Table 15b. Reasons for stimulating ex-informal businesses to formality by sector	33
Table 16. Reasons for not formalizing : perceptions of Community Leaders.....	34
Table 17. Measures that would stimulate formalizing.....	34
Table 18. Possession of required licenses by sector	35
Table 19. Reasons for not acquiring required licenses by sector.....	36
Table 20. Actual and Perceived reasons for not acquiring required licenses.....	36
Table 21. Reasons for not obtaining product standards certificates by sector	38
Table 22. Reasons to no acquire legal land by business size.....	40
Table 23. Key reasons for not reporting workers to authorities	42
Table 24. Key reasons for under-reporting salaries to authorities by size of business.....	43
Table 25. Percentage of turnover reported for tax purposes by size of business (% of businesses)	45
Table 26. Percentage of turnover reported for tax purposes by sector (% of businesses).....	45
Table 27. Percentage of sales reinvested in business (% of businesses)	46
Table 28. Businesses that applied for a loan by sector (%)	46
Table 29. Result of loan application (% of businesses)	47
Table 30. Reason for not applying for a loan.....	47
Table 31. Obstacles for business operation and growth (% of respondents claiming an issue is an obstacle).....	48

List of Boxes:

Box 1. Formal and informal business establishments in Sierra Leone	3
Box 2. The costs of Informality	4
Box 3. Definition of Informality	8
Box 4. Summary of Key Survey Findings	10
Box 5. Highlights of findings on Gender and Informality.....	17
Box 6. Dealing with License in Sierra Leone	36
Box 7. Paying Taxes in Sierra Leone.....	45

1. Introduction

Background

The Foreign Investment Advisory Service (FIAS), at the request of the Government of Sierra Leone, undertook a *Survey of the Characteristics and Sources of Informal Economy Activity* in Sierra Leone. The survey was carried out in conjunction with *Statistics Sierra Leone* in the four regions of Sierra Leone during April 2006.

A study of administrative barriers in Sierra Leone (FIAS, 2005) revealed that in every aspect of the investment process (start-up, locating, and operating), most firms find it simpler and more cost effective to remain in the informal sector than to comply with licensing, tax, and other official requirements to start and operate a business. Reducing incentives for informality was thereby identified as a priority for Sierra Leone as it emerges from a post-conflict phase to a growth phase.

The objective of this study is to report the findings of the survey of informal and formal businesses in Sierra Leone to identify the main policy and administrative barriers to business formalization. These results will form the basis for further analysis of the sources of informality which will aim to provide concrete policy recommendations to increase business formalization.

Part I of the study consists of the survey analysis report. Section II presents an Executive Summary with highlights of the survey results. Section III discusses the survey findings in more detail. Section III begins with sub-section 1 on results of general and informality-status related characteristics of the businesses surveyed. Sub-section 2 reports perceptions of the advantages and disadvantages of informality. This is followed by a discussion in Sub-section 3 of the key reasons for informal activity and government actions that could stimulate formalization. Sub-sections 4-9 report results on the different types of informality: licensing, product standard, land, labor and tax. Finally, financing issues are discussed in Sub-section 9, followed by general obstacles for business operation in Sub-section 10.

Part II consists of a compilation of annexes (survey questionnaires, methodology, sampling design, training manual), and Part III presents the data tables.

The Economic Context

Sierra Leone's economy is heavily dependent on the agricultural and mining (diamonds, gold and rutile) sectors. The agricultural sector accounts for over 50% of GDP, and two-thirds of the population is engaged in subsistence agriculture. The main exports are coffee and cocoa, and mainly from the Eastern Region. Mineral exports remain Sierra Leone's principal foreign exchange earner, and are concentrated in the South. Though Sierra Leone is a major producer of gem-quality diamonds, it has struggled to manage its exploitation and export. Industry accounts for about 30% of GDP (primarily mining) and the services sector for another 17%. See Table 1 for sectoral growth rates and contribution to GDP.

Sierra Leone's macroeconomic performance during 2001–04 was strong overall. Annual output growth averaged 15.5% during the post-conflict period, and the recovery was broad-based. Real GDP growth in 2005 is estimated at 7.3%, driven by a recovery in agriculture and mining output and continued growth in services. However, as the post-war recovery phase comes to an end, Sierra Leone's economic growth is forecast to slow. Sierra Leone's growth is constrained by a number of bottlenecks, including corruption, bureaucracy and a lack of investor confidence (outside the mining sector). The domestic economy will need to be diversified to create employment and generate tax and export revenue, as donor funding at current levels will not continue indefinitely.

Table 1. GDP growth rates and shares by Sector, 2000-03

	GDP growth (%)	Share (% of GDP)
Agriculture, Forestry, and Fishing	4.6	47.2
Agriculture	4.4	31.9
Livestock	5.0	2.9
Forestry	5.2	3.0
Fishery	5.9	9.4
Industry	6.4	24.5
Mining and quarrying	5.8	19.5
Manufacturing and Handicrafts	6.9	2.5
Electricity and Water Supply	8.5	0.3
Construction	8.1	2.2
Services	5.3	22.6
Trade and Tourism	5.3	5.4
Transport, Storage and Communication	6.2	4.6
Finance, Insurance and Real Estate	6.3	4.6
Government Services	4.1	4.3
Other Services	3.7	3.8

Source: National Accounts of Sierra Leone, Statistics Sierra Leone.

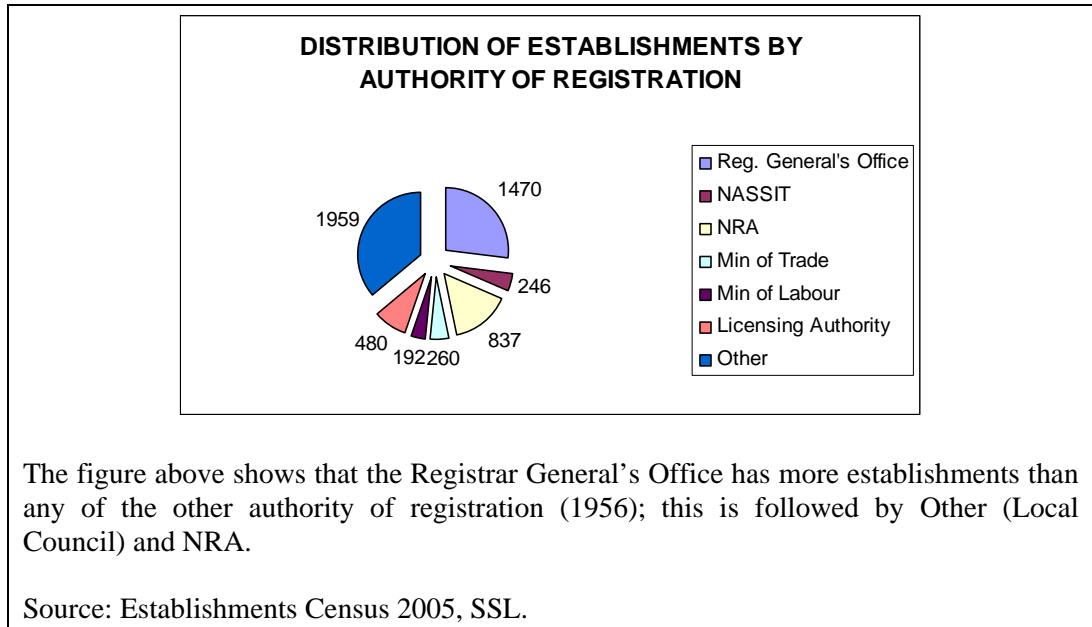
The Informal Economy

The informal economy in Sierra Leone is estimated at about 45 percent of GDP.¹ The Census of Business Establishments (2005) estimates that two-thirds of businesses are not registered with any government agency and thereby operating in the informal sector (see Box 1).

Box 1. Formal and Informal Business Establishments in Sierra Leone

According to the Census of Business Establishments (2005), out of the 10,840 establishments canvassed, 35% were registered with the Administrator and Registrar General's Office, National Social Security and Insurance Fund (NASSIT), National Revenue Authority (NRA), Ministry of Trade, Ministry of Labor, Licensing Authority, or other (Local Council) authority. This means that 66% business establishments were 'Not Registered' establishments. This category of establishments (i.e. 'Not Registered') constitutes the informal sector of the economy.

¹ Doing Business Database, World Bank, 2005.



There are high economic and social costs of informality (see Box 2). Activities in the informal sector are less productive than formal ones,² and operations tend to be sub-scale and sub-invested as they lack access to finance or avoid the scope of regulators. In addition, informal sector employees do not benefit from social protection, and companies do not have the resources or incentives to provide them with training. At the macroeconomic level, the government loses on substantial potential tax revenues. Also, firms adapt to an unregulated environment, while formal sector firms compete with an un-level playing field. As a result, informality is a binding constraint to growth.³

Box 2. The Costs of Informality

Though informality offers obviously benefits to **businesses** by evading taxes, social contributions, regulatory fees and compliance cost, it comes also at a price, such as:

- ***Limitation on investment and company growth.*** Companies in the informal sector need to operate under the radar of the administration. This means they try to avoid attracting attention of the government. Owners of informal enterprises usually prefer to keep the company at a size that allows operating within the informal sector. Furthermore, the lack of accessing finance puts a limit to investments and growth of informal enterprises.
- ***No participation in public incentive schemes and public procurement contracts.***

² Studies show that, on average in a given industry, informal companies are three times less productive than formal ones (McKinsey Global Institute).

³ It is estimated that informality is costing countries such as India, Turkey, Russia and Brazil between 1-2% in annual economic growth (MGI).

By nature, informal enterprises cannot apply for incentives offered by the government. In addition, informal businesses are usually not allowed to bid for public contracts. Public procurement contracts constitute often a considerable part of the economic activities in developing countries.

- **Lower productivity.** Informal enterprises operate in an uncertain state and do not invest in the company and its employees. The informal business operates typically with outdated machinery and untrained personnel below its potential productivity. Often, the owner of the enterprise can only effort this unproductive business because he or she saves other costs due to its illegal status.
- **Costly measures to stay informal.** To stay outside the regulatory framework comes often not without a price. Measures must be undertaken to stay outside the view of the public administration. This includes, for example, abrupt changes of location or activities, bribes, closures and new establishments, splitting the business into several smaller units at various locations, etc.

Entrepreneurs decide to stay informal because the total costs of entry, operation, and exit associated with joining the formal sector are greater than the potential benefits from being formal. They are willing to forgo the benefits of better protection of property rights and to bear the cost of extra-legality (in the form of bribes, costly finance, etc.) because it is more beneficial to remain informal.

Informality has a negative effect on the **labor force** because of:

- **Non-coverage by minimum wage legislation and social security system.** Informal enterprises do not offer social protection and often pay below minimum wage or union wages.
- **Absence of trade union organization.** Employees of informal enterprises are not represented by their unions in collective agreements and often do not receive individual support.
- **Low income and wages.** Wages are below the wages negotiated by employer organizations and unions in collective agreements.
- **Little job security.** Labor protection rules are often not applied such as redundancy rules, requirements to lay-off employees, paid holidays, maternity leaves, severance payments.

Source: FIAS (2005).

Research finds that entrepreneurs make formalization decisions based on cost/benefit analysis, and that they will operate formally up to the point where the marginal costs are less than the benefits of formality.⁴ The key policies which perpetuate informality include⁵:

- **Lack of information.** Firms, in particular smaller ones, may not have access to information on how to register or operate a firm. In addition,

⁴ SIDA 2004.

⁵ Source: "The Informality Problem: Diagnosis and Solution Design", FIAS, 2005.

entrepreneurs may not be aware of the medium- and long-term costs of operating in the informal sector.

- ***High taxes and social contributions.*** High tax rates or problems with tax administration may provide a strong incentive to be informal. In addition, the growth of formal companies is constrained by a heavy tax burden.
- ***High start-up costs.*** New enterprises often cannot afford high start-up costs in form of fees for registration, approvals and licenses as well as stamp duties and obligatory notary public services. Cumbersome and costly business registration procedures discourage poor entrepreneurs to register their business.
- ***Administrative barriers.*** Start-up procedures may be designed in an inefficient manner asking new businesses to go through a high number of steps and submitting documentation that itself takes a lot of time and money to produce. Some procedures are even designed to leave the applicant in limbo for a long time. In many cases, the start-up procedures are duplicated on several levels of administration, for example with general licenses to be obtained on federal, state and municipality level.
- ***Land.*** Procedures to register land force and/or encourage companies to operate on informal land. Land related informality has two dire economic consequences. First, it prevents many small businesses to access the capital markets because they cannot pledge their real estate as loan collateral. The second consequence is that it allows well-connected businesses, such as operators of open air markets in Russia, to access prime informal or government land at way below the fair market rate.
- ***Rigid labor market rules.*** Rigid labor market rules combined with high labor related taxation such as hefty social contributions discourage companies to hire formally their employees, and rely on informal subcontractors. The Doing Business project of the World Bank has shown a strong correlation between these labor rules and the level of informal labor.
- ***Inadequate sector specific policies.*** Sector-specific policy can also encourage companies to operate informally. For example, overly restrictive health standards fuel informality in food processing; consequently, food processors remain sub-scale and that most food production in the developing world escapes completely any kind of control. Standards are usually adopted to ensure consumer, labor and environmental protection. Informal enterprises operating outside the

regulatory framework do not need to fulfill the obligatory standards and requirements set by the state.

- ***Weak enforcement poses a low risk of detection.*** The lack of capacity and/or commitment diminishes the risk of informally operating businesses to be discovered. Many company registrars do not follow up on missing annual returns and licensing authorities do not enforce the obligation to operate with a valid license. Standardization offices, tax authorities, or customs do not have a sufficient number of experienced inspectors. The involved authorities lack an effective system of information exchange, which give businesses the chance to be partially informal without the risk of being detected. In addition, penalties are often not updated and do not pose a threat to the informal sector.

2. Executive Summary

The survey sample consists of 1362 businesses across Sierra Leone. Separate survey instruments were applied to three groups of respondents: totally informal businesses, formal/partially informal businesses, and community leaders.

For the purposes of the survey, informality is defined as lack of compliance with legal and procedural requirements for business operation (see Box 3). Informal businesses are those that do not provide information about their businesses activities to one or more government agencies at any level.

Box 3. Definition of Informality

Informality is represented by a continuum between the completely formal and informal economy. In this study, informal businesses are defined as those that do not comply with government regulations (e.g. registering with tax authorities) and requirements (e.g. filing tax returns), and includes:

Totally informal firms, which do not comply with any government regulations and requirements, and are unknown to the government.

Partially informal firms, which comply with at least one government regulation.

On the other hand, *formal businesses* are those that comply with all government regulations and requirements.

In the data analysis, businesses are categorized by:

- Formality status: completely informal or formal/partially formal.
- Sector: manufacturing, trade, services, agriculture, and construction.
- Size: 3 and less, 4-10, and more than 10 employees.
- Location of business: Western Area, Southern Region, Northern Region, Eastern Region.
- Level of business operation: Chiefdom, District, and Higher than Region.
- Gender of respondent.
- Age of respondent: Less than 25, 25-34, 35-44, 45-54, and 55 and more.

The sectoral distribution of the sample was based on the Census of Business Establishments (2005), and adjusted to ensure a 10% minimal contribution of most sectors. According the Census of Business Establishment, most establishments (65%) are operating in retail trade.

Many businesses (except mining and agriculture) are concentrated in the Western Area, especially in Freetown, given the amenities such as the sea port, other infrastructure, and tourism facilities. The mining sector is mainly in the Southern and Northern Regions, and agriculture in the Eastern Region.

Key findings of the survey are summarized below, primarily by formality status. Results defined by other characteristics (size, location, sector etc) are discussed in more detail in Section II. The main findings of the survey are summarized in Box 4. Highlights of results in relation to female entrepreneurs, who typically are more prominent in the informal economy, are found in Box 5.

Lack of access to information

One cross-cutting finding from the survey is the lack of available information on the steps and procedures for business formalization in Sierra Leone. The FIAS Administrative Barriers Study (2005) identified the lack of access to information as a constraint to growth and investment. The report identified the (i) lack of centralized, user-friendly (computerized) information repositories, (ii) registries, and (iii) information dissemination mechanisms for the general public (on procedures, requirements, costs, timeframes etc), as all providing incentives for firms to circumvent regulations and procedures and to operate informally. This was particularly the case in licensing, land acquisition and titling, customs and the labor market. For example, there were no national registries for land ownership, which resulted in multiple sales of the same parcel of land. This survey reinforces the perception of information constraints, in particular for informal and smaller businesses.

Box 4. Summary of Key Survey Findings

Informality Characteristics

- Between 40-80% of businesses are unregistered according to most community leaders.
- Most formal/partially formal businesses formalized through tax registration.
- The majority of respondents believe that it is more advantageous to operate as a formal business.
- The main advantages of informality are considered to be the avoidance of licensing problems, labor taxes and contributions, and income/profit tax.
- The key factors behind the *most* important advantage of informality – labor taxes/regulation - are absence of information, financial burden, and lack of enforcement, equivalent to 20% of annual sales on average.
- The main disadvantages of informality are perceived to be limited access to finance, the need to pay bribes to avoid formal procedures, and the fear of government retribution. In addition, lack of access to the broader market and access/price of utilities are amongst the key disadvantages for many completely informal businesses.
- One-fifth of businesses surveyed incurred some payment over the previous year to sustain their informal status.

Reasons for Informality / Incentives for Formalization

- Businesses decide to operate informally due to licensing and tax issues, and lack of information.
- The majority of completely informal businesses are not well informed about the necessary steps to become fully formal.
- One-quarter of completely informal businesses have attempted to become formal.
- Businesses failed to formalize because of expensive and complicated procedures and lack of information.
- Most completely informal businesses surveyed are likely to consider becoming formal over the next two years, especially if information became more freely available.
- Businesses that were unlikely to formalize would re-consider their stance if the government provided incentives such as reduced taxes and increased transparency of start-up requirements.
- Half the businesses surveyed operated in the informal economy before moving to the formal sector.
- Government measures that would stimulate formalization include better access to information and reduction of administrative barriers in general.

Types of Informality

- Most formal/partially formal respondents claim to have the necessary licenses to operate, whereas 10% do not have the required licenses.
- High licensing costs, requirements, and lack of information are cited as reasons for businesses not possessing all required licenses.

- About one-sixth of businesses do not possess product standards certificates. Product standards certificates are not obtained mainly due to high costs and requirements, lack of information, and unclear certificate policy in sector.
- Businesses operate on land without rights because of land costs, administrative barriers and lack of information.
- Over half the businesses surveyed are believed to report less than half of their workers.
- The reasons behind not reporting all *employees* include high income tax, hiring and firing regulations, and high social security contributions.
- Most businesses under-report the *salaries* of employees. The most cited reasons are high income tax and high pension contributions.
- The majority of businesses report less than half of turnover for tax purposes

General obstacles to growth

- Completely informal businesses reinvested less of their past sales than formal/partially businesses
- Most businesses have not applied for a loan for business purposes in the past two years.
- One-third of loan applications were rejected, especially for completely informal businesses.
- Access and cost of financing are identified by the most businesses as general obstacles for business growth.

Informality Characteristics

According to the majority of community leaders the shares of unregistered businesses in their communities is between 40-80%. In the Eastern Region, which is primarily agricultural, 40% of community leaders believe that more than as 80% of businesses are unregistered.

Most formal/partially formal businesses in the survey formalized through tax registration, particularly those that operate at the Chiefdom level. The majority of businesses that formalized within the last 1-2 years are those with less than 3 workers, concentrated in the Eastern Region, and proportionately higher within the trade and services sectors. The majority that formalized between 5-10 years ago were in businesses with more than 4 workers, in the Western and Southern regions, and higher within the construction, agriculture and manufacturing sectors.

Advantages and Disadvantages of Informality

The survey shows that the majority of respondents perceive that it is more advantageous to operate as a formal business. As such, over 56% of businesses

believe formal businesses are in a better or much better situation than their informal counterparts.

The main perceived advantages of informality are the avoidance of licensing problems, labor taxes and contributions, and income/profit tax. The majority of businesses consider that the three main advantages of informality include no licensing problems (51% of businesses), no labor taxes and contributions (47%), no income/profit tax (43%), and avoidance of labor regulations/more flexible work (31%), amongst others.

In terms of the most important advantage of informality, almost 45% of businesses (in particular formal and partially formal) consider this is labor-related i.e. the avoidance of labor taxes/contributions and avoidance of labor regulations/flexibility of labor.

The key factors behind the most important advantage of informality are absence of information, financial burden, and lack of enforcement. For formal/partially formal businesses, the main aspects behind the most important advantage of informality are: the absence of effort to find information (66% of businesses), financial burden of being formal (62%), and lack of enforcement (59%). For completely informal businesses, the main aspects are: absence of effort to find information (58%), financial burden (52%) and – in contrast to the view of formal/partially formal counterparts – avoiding harassment by public officials (49%).

The three most important disadvantages of informality are considered to be limited access to finance, the need to pay bribes to avoid formal procedures, and the fear of government retribution. In addition, relatively more businesses that are completely informal find that both lack of access to the broader market and access/price of utilities are amongst the key disadvantages compared to their more formal counterparts. The most important perceived disadvantage of informality again includes limited access to finance (45% of businesses), or bribes (16%), or limited access to raw materials (7.4%), or fear of government retribution (6.8%).

Direct Costs of Informality

One-fifth of businesses surveyed incurred some payment over the previous one year to sustain their informal status. The cost of maintaining informal businesses was on average about 20% of sales over the last year. The average payment incurred was SL 1,062,224 (US\$450), while the median payment was SL 80,000 (US\$35). This is very high given that Sierra Leone's GNI per capita is about US\$200.

Female respondents incurred about five times the mean ‘costs’ compared to males, or SL 2,624,581 (US\$1,116) compared to SL 512,825 (US\$218) for males. Also, as much as 68% of female respondent had ‘other burdens’ compared to 58% of males.

Reasons for Informality

Businesses decide to operate informally due to licensing and tax issues, and lack of information. About 86% of businesses believe that the high cost and burden of licenses is the most important reason for informality, and about 75% consider this to be tax burden and administration or lack of information. More completely informal businesses consider the lack of information as a key reason compared to formal/partially formal businesses.

The majority of completely informal businesses are not well informed about the necessary steps to become fully formal. About 36% of completely informal businesses know nothing about the procedures for formalization in their area of business, and another 40% only know a few details.

One-quarter of completely informal businesses have attempted to become formal.

Businesses failed to formalize because of expensive and complicated procedures and lack of information. Over 27% of completely informal businesses failed in their attempt to come formal because the steps were too costly, 26% due to complicated steps, and 22% because they were unable to find all necessary information. Interestingly, more businesses that are larger in size could not find the necessary information – 38% of businesses with more than 10 workers, compared to 18% of those with 3 and less workers.

Incentives to Formalize

Most completely informal businesses surveyed are likely to consider becoming formal over the next two years. About 75% of businesses may/probably will consider formalization in the next two years, while 7% are almost certain to. Factors that have pushed businesses to *consider* formalizing included increased information availability, high ‘payments’ to maintain informal status, and high official penalties. It is interesting to note that the majority of businesses (56%) would seriously consider becoming formal if information on the procedures required became more freely available.

Respondents that stated few chances of considering formalization would reconsider their stance if the government provided incentives such as reduced taxes. Government measures that would act as incentives to become formal

include reduced taxes (88% of businesses), increased transparency of all procedures especially start-up requirements (69%), tax incentives (60%) and reduced administrative barriers (60%).

Half the businesses surveyed operated in the informal economy before moving to the formal sector. The key reasons that pushed businesses in the formal sector were information availability, business expansion, high costs to maintain informal status (high penalties, shutdown expenses and other expenses to sustain informality except bribes/informal payments), and realization that taxes are not high and tax administration as fair.

Government measures that would stimulate formalization include better access to information and reduction of administrative barriers in general. About 70% of community leaders surveyed believe that increased availability of information would help businesses formalize (97% in the Southern Region). As many community leaders perceive that reduction of administrative barriers would provide incentives to formalize. In terms of the most important measure to increase formalization, almost 50% of all community leaders consider this to be improving access to finance.

Licensing Informality

Most formal/partially formal respondents claim to have the necessary licenses to operate. However, 10% of formal/partially formal respondents do not possess the specific licenses that are required in their area of operation, and another 5% state that they do not require licenses to operate.

High licensing costs, requirements, and lack of information are cited as reasons for businesses not possessing all required licenses. About 80% of formal/partially formal businesses state that the reasons for not having required licenses – either themselves or competitors – are high costs and requirements for obtaining licenses. Almost 70% cite lack of information on licensing requirements. According to the Administrative Barriers Study (FIAS, 2005) there was only one copy of the list available of licenses and fees at the City Council in Freetown, making information availability a problem for the issuance of licenses.

Weak enforcement is an important reason for licensing informality for more businesses operating in the Northern Region compared to other regions, and for those with lower levels of operation. The FIAS Administrative Barriers Study highlighted weak enforcement of licensing requirements, and many companies are believed to not renew licenses with the OARG, the municipality or the line-ministries. Overall, the licensing regime was described as appearing to be cumbersome, uncoordinated and opaque.

Product Standards Informality

About one-sixth of businesses do not possess product standards certificates. Product standards certificates are not obtained mainly due to high costs and requirements (70% of businesses), lack of information, and unclear certificate policy in sector.

Land Informality

The survey reveals that the majority of businesses lease private land for their business activity. Of the businesses that use land in their everyday operations, over 50% lease private land. More smaller-sized businesses lease private land (55% of businesses with 3 or less workers).

Businesses operate on land without rights because of land costs, administrative barriers and lack of information. As much as 85% of all formal/partially formal businesses – both those that have some land rights and those that use land without rights – believe that the reason businesses operate on informal land is that land costs are too high. A majority of businesses surveyed that use land without rights (64% of this group) also cite complicated and expensive administrative barriers related to land purchase/lease, as well as lack of information.

About 57% of businesses attribute land informality to difficulty in finding who has the official land title, and weak enforcement for using land without rights. According to the Administrative Barriers Study (FIAS, 2005), it is common for land to be registered to a number of owners through the Office of the Administrator and Registrar General (OARG). This is because OARG does not verify land tenure, ownership, the land survey, or check if the land was legally owned by the person who sold the property.

Labor Informality

Over half the businesses surveyed are believed to report less than half of their workers. Of these, as much as 35% of formal/partially formal businesses think that other businesses in their area of operation do not report any of their workers to the authorities.

The reasons behind not reporting all employees include high income tax, hiring and firing regulations, and high social security contributions. The majority of formal/partially formal respondents (80%) consider one of the reasons for other businesses not reporting all workers to authorities is high income tax, as well as health, unemployment and retirement contributions (over 50% of businesses).

Most businesses under-report the salaries of employees. About 60% of formal/partially formal businesses believe that other businesses in their area of operation report less than 50% of the salaries of their employees for taxes and contributions. The most cited reasons are high income tax (80% of businesses) high pension contributions (65%).

Tax Informality

The majority of businesses report less than half of turnover for tax purposes. Respondents claim that 60% of formal/partially formal businesses in their area of business report less than 50% of their turnover for tax.

About 16% of businesses are believed to report 0% business turnover. These are primarily larger firms, those operating at the Chiefdom and District level, and in the Southern Region (40% of businesses).

As discussed in the Administrative Barriers Study (FIAS, 2005), the overall tax regime is biased such that it provides incentives for firms to operate informally. Some of Sierra Leone's tax policies, such as imputed taxes based on revenues and profits imposed on unregistered businesses, were designed to broaden the tax base and bring informal enterprises into the formal economy. However, the arbitrary way in which these taxes are assessed may have the opposite effect, and may prevent small businesses from moving to the formal economy.

Reinvested Sales

Completely informal businesses reinvested less of their past sales than formal/partially businesses. Over half of businesses reinvested between 20-60% of their sales over the past year. About 10% of all businesses did not reinvest any of their sales in the last year, including relatively more completely informal businesses and those operated by females.

Loans Applications

Most businesses (80%) have not applied for a loan for business purposes in the past two years. Of these, over 50% of businesses did not make a loan application because they 'know they cannot get one'.

Of those that applied, about one-third of loan applications were rejected, especially for completely informal businesses. Almost 45% of completely informal businesses had loan applications rejected over the past two years, compared to less than 30% of formal/partially formal businesses.

General Obstacles for Business Operation

Access and cost of financing are identified by the most businesses as problems in the investment climate. Access to and cost of financing (87% and 78% of businesses respectively) are considered by respondents as a key obstacle for business operation and growth. In addition, almost 75% of businesses consider transportation infrastructure and availability of electricity as constraints. Over 60% of community leaders consider the lack of availability of information from the government as an impediment to business growth.

Box 5. Highlights of findings on Gender and Informality

Informality can perpetuate gender inequalities, and evidence suggests that the majority of economically active women in developing countries are in the informal economy. The survey reveals the following key aspects of informality from women entrepreneurs:

- Of the respondents, 30% of the female respondents do have no or unfinished primary education, compared to 14% of males.
- More female respondents perceive that informal businesses are in a 'better situation' (16% vs 10% for males), compared to a 'better situation' for formal businesses (32% vs 41% for males).
- The majority of female respondents consider the most important advantage of informality is labor related (taxes and regulations) or licensing problems. In contrast to males, relatively more females regard access to the black market and easier/cheaper access to raw materials as the most important advantage of informality.
- The average 'cost' (informal payments) incurred by female respondents to operate informally was five times that of males.
- 68% of female respondents incurred 'other burdens' to sustain their informal status compared to 58% of males.
- About 41% of females know nothing about the necessary procedures required to formalize in their line of business versus 33% of males.
- Less female respondents have tried to formalize (22% vs 30% for males), and are less likely to consider formalization over the next two years.
- 65% of female respondents would formalize if information became more easily available about the required steps.
- 48% of female respondents operated informally for a while before formalizing, compared to 44% of males.
- More female respondents (54%) had a loan application approved over the past two years compared to males (42%).

Sectoral Analysis

The survey results reveal that the reasons behind the decision to operate informally vary between sectors. Relatively more businesses in the construction sector cite the high cost and burden of licenses. As a result, more businesses in construction (15%) do not have the required licenses compared to other sectors. Taxes are also stated as a reason for informal operations by proportionately more construction businesses. In addition, significantly more construction businesses cite labor markets rules. Thus, 70% of businesses in the construction sector consider the *most* important advantage of informality as avoiding labor taxes/contributions and regulations, and flexibility of labor. This reflects the high informal labor typically employed in this sector.

Businesses are less likely to formalize in the agricultural and construction sectors. Most of the businesses that know nothing about the steps for formalization in their area of business operate in the construction (57% of businesses in this sector) and agricultural (51%) sectors. In the agricultural sector, over 30% of businesses operate informally because of ‘social expectations’. For example, almost 40% of businesses claim to not need licenses to operate. In addition, more businesses in the agricultural and construction sectors do not report *any* workers compared to other regions.

More completely informal businesses in the manufacturing sector (35%) attempted to become formal. Amongst those that failed to formalize, the cost of procedures was an impediment for more businesses in the manufacturing and construction sectors. The lack of information was particularly experienced by businesses in the agricultural sector (50% of businesses).

Relatively more businesses (over half) in the manufacturing and construction sectors operated informally before formalizing. Over 80% of all manufacturing businesses became formal because information on the required procedures became available. As much as 88% of businesses in the agricultural sector became formal because they wanted to expand. Also, over 80% of businesses in the agricultural sector were forced to formalize due to high official penalties.

Businesses in the manufacturing, trade and services sectors are more likely to become formal. More businesses in the manufacturing sector would ‘seriously’ consider formalization for all the reasons cited in Table 15a, including triggers such as increased information availability, better access to customers and suppliers, high official penalties, and high cost of ‘payments’ to maintain informal status. For example, more businesses in the manufacturing sector (31%) incurred expenses to operate informally. However, the mean ‘costs’ were highest in trade, and the median ‘costs’ highest in services. ‘Other burdens’ were highest in the manufacturing and agricultural sectors.

Regional Analysis

Informal activity is pervasive in all regions of Sierra Leone. The highest concentration of unregistered businesses is in the Eastern Region, where over 40% of community leaders believe that more than 80% of businesses are unregistered. This region is dominated by agricultural activity. Nevertheless, in all regions, most community leaders claim that between 40-80% are unregistered. Some highlights of the survey findings point to informality in the Northern and Southern regions, and include:

- More businesses in the Northern Region (16%) do not possess required **licenses** compared to other regions (7% or less), for which weak enforcement is a more important reason (75% of businesses).
- In the Northern Region, about 23% of businesses do not have required **product standard certificates**, higher than in other regions.
- Again, in the Northern Region, almost 40% of businesses operate on **land** without rights. Amongst the factors behind land-related informality, more businesses in the Western Area and Southern Region believe that high land costs are a key factor. Difficulty in finding land titles is significant for more businesses in the Western Area.
- Relatively more businesses in the Southern region (63%) are believed to not report any **workers** compared to other regions.
- Of the businesses that report none of their workers **salaries**, relatively more are concentrated in the Southern Region (60% of businesses in that region),
- About 40% of businesses in the Southern region report no turnover for **tax** purposes.
- Avoiding **administrative costs** are one of the key advantages of informality for more businesses in the the Northern and Southern regions.
- Limited **access to finance** is a more important disadvantage of informality in the Western Area and Northern Region than in other regions.

With respect to the factors behind informal activity, more businesses in the Southern and Northern regions (over 85%) consider the lack of information as a key reason for informality. In addition, as much as 66% of businesses in the Northern Region believe that firms operate informally because they see no benefit of being formal.

Businesses that know nothing about the steps are concentrated in the Southern and Northern regions. On the other hand, businesses that are relatively well informed or know exactly what steps are required to become formal are in the Eastern and Western regions.

Businesses are less likely to formalize in the Southern and Northern regions.

However, the majority of completely informal businesses in the Southern Region (90%) would seriously consider becoming formal if information on the procedures required became more freely available. In addition, more respondents in the Western Area and Northern Region would re-consider formalization if provided with tax-related incentives. Increased transparency and reduced administrative barriers are significant incentives for relatively more businesses in Southern and Northern regions.

More businesses in the Eastern Region (42%) and Western Area (35%) tried to formalize in the past. However, businesses that tried to formalize failed because of lack of information for businesses (50%) in the Southern region, and the cost of procedures for businesses (45%) in the Western Area.

Ex-informal businesses in the Eastern and Northern regions mainly formalized through tax registration (65% and 36% respectively). In the Western Area, most businesses formalized through registration with the Office of Administration and Registrar General (ODRG). More ex-informal businesses in the Northern Region move to the formal sector due to all the factors listed in Table 15a. However, high bribes to sustain informality were a primary factor in the Western Area.

Policy Implications

Since the triggers for informality are likely to vary between countries, this survey was carried out in Sierra Leone to assist the Government better understand the precise policy or regulatory incentives/disincentives to formalization - as viewed by its entrepreneurs - in order to best design a reform program that has the objective of reducing informality.

The survey reveals that there is a significant opportunity for business formalization in Sierra Leone. Over 80% of completely informal businesses surveyed are likely/certain to consider becoming formal over the next two years. As many as 56% would ‘seriously’ consider becoming formal if information became more freely available. In addition, 27% of completely informal businesses have tried to formalize, but failed because of expensive and complicated procedures and lack of information.

The survey results point to some priority reform areas to address informality. Businesses identified several key reasons as to why they remained informal. **First, licensing** related issues are identified by the majority of both formal/partially formal and completely informal businesses of all sizes. The main factors are high licensing costs and requirements, and lack of information. Licensing

reform will primarily target completely informal businesses, since only 10% of formal/partially formal businesses claim to not have the required licenses.

Second, most businesses claim to operate informally because of the **tax system**. This includes high (or ‘potentially’ high for completely informal businesses) financial and administrative burdens. In fact, the majority of businesses that stated few chances of considering formalization would re-consider their stance if taxes were reduced and tax incentives provided. *Third*, **lack of information** about procedures and requirements for formalization is a dominant factor behind informal operations. Only about 7% of businesses surveyed are well informed about the steps required to become formal. In addition, most of the businesses in the sample that moved to the formal economy in the past did so because information on the required procedures became available.

The survey highlights other factors that would push businesses to formalize. For most businesses, the **access and cost of financing** are a key obstacle for business operation and growth. Limited access to finance is considered by almost 65% of businesses as the main disadvantage of being informal. Hence, half of the community leaders consider improving access to finance as the *most* important government measure which could increase formalization.

Two of the other most important disadvantages of informality are considered to be the need to pay **bribes** to avoid formal procedures, and the **fear of government retribution** for staying informal. In fact, the majority of businesses state that the *most* significant factor for ‘seriously considering’ becoming formal is high official penalties. These penalties are also one of the main reasons cited by ex-informal businesses for their formalization in the past. High bribes are also cited a trigger to ‘seriously consider’ formalization.

These findings underscore that formalization decisions hinge on a cost/benefit calculation. The results also indicate that government policies should provide businesses incentives to formalize as discussed above, while not overly burdening businesses with official penalties and bribes – particularly those businesses that may wish to formalize but are unable to due to administrative burdens and lack of information.

Next Steps

In the next stage, further analysis will be carried out using the survey results to develop a strategic solution design plan for business formalization. The solution design will focus on tackling some of the causes of informality which are the most important from an economic and social point of view, that is, those that will have the most sustained impact.

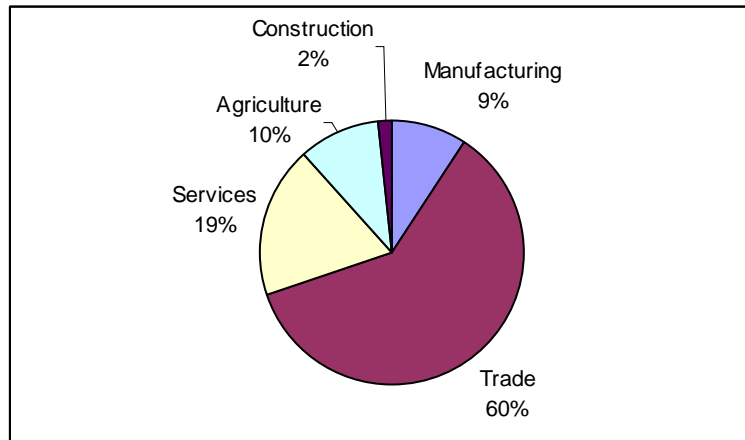
3. Survey Results

Characteristics and Structure of the Survey Sample

General Characteristics

The survey sample consists of 1362 businesses in Sierra Leone, of which 703 are formal or partially formal, and 659 completely informal. The businesses are distributed evenly between the Northern, Eastern, Southern regions and Western Area. The sectors of operation of the businesses surveyed cover primarily trade (58%), as well as services (18%), agriculture (10%), manufacturing (9%) and construction (see Figure 1).⁶

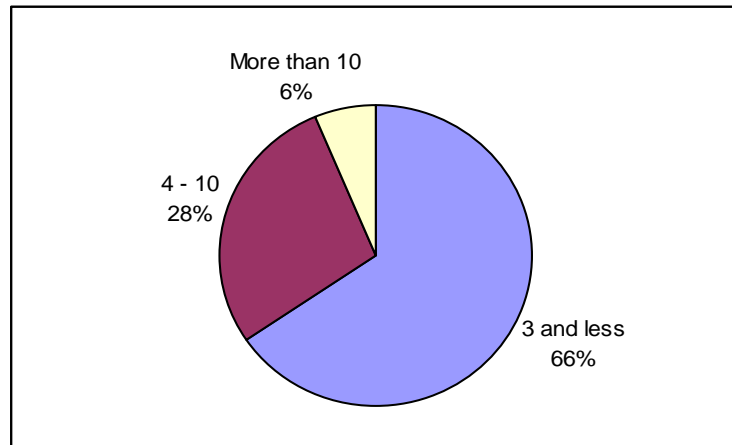
Figure 1. Distribution of Businesses by Activity



About 93% of the firms in the sample are small and micro enterprises that comprise less than 10 workers, and 65% between 4-10 workers (see Figure 2). However, about 50% of businesses in the agriculture sector have more than 10 workers.

⁶ This sectoral distribution is based on the Census of Business Establishments and adjusted to ensure a minimum 10% sectoral representation of most sectors in the sample.

Figure 2. Distribution of Businesses by Size (number of employees)



Over half of the firms surveyed have been in operation for between 1-5 years, of which 30% for between 2-5 years (see Table 1). In terms of geographic level of operation, about 73% of formal/partially formal firms, and 63% of completely informal firms operate only as wide as the Chiefdom level. Another 20% of all firms surveyed operate up to the district level. Over 80% of firms operate at the Chiefdom level in the Eastern and Southern regions, where the agricultural and mining sectors are concentrated. It is interesting to note that 4% of completely informal firms in the sample operate at the national level and over 1% at the international level.

Table 2. Years of Operation

			Formality status		
			Total	Formal or partially formal	Completely informal
Years of operation	Less than a year	%	8.0	12.5	3.2
	1 - 2 years	%	20.8	17.9	23.8
	More than 2, less than 5	%	30.1	28.3	32.0
	More than 5, less than 10	%	18.1	17.2	19.1
	More than 10	%	10.9	8.3	13.8
	No answer	%	12.0	15.8	8.0
	Total	N	1,362	703	659

For the majority of businesses (70%), the number of workers has remained the same compared to the previous year. However, twice the number of formal/partially formal businesses (19%) decreased workers compared to completely informal businesses (9%). Businesses that increased workers (17%) are larger businesses (more than 10 workers), mainly manufacturing and construction, that operate at a level higher than the region, and are primarily owned/managed by males.

Annual sales remained the same in the last year for the majority of businesses (43%). Compared to the previous year, annual sales increased for 50% of businesses in the Western Area, remained the same for 60% of businesses in the

Eastern Region, and decreased for 30% of businesses in the Northern Region. Among sectors, annual sales increased the most for the construction sector (55% of businesses) and decreased the most for the agricultural sector (34%).

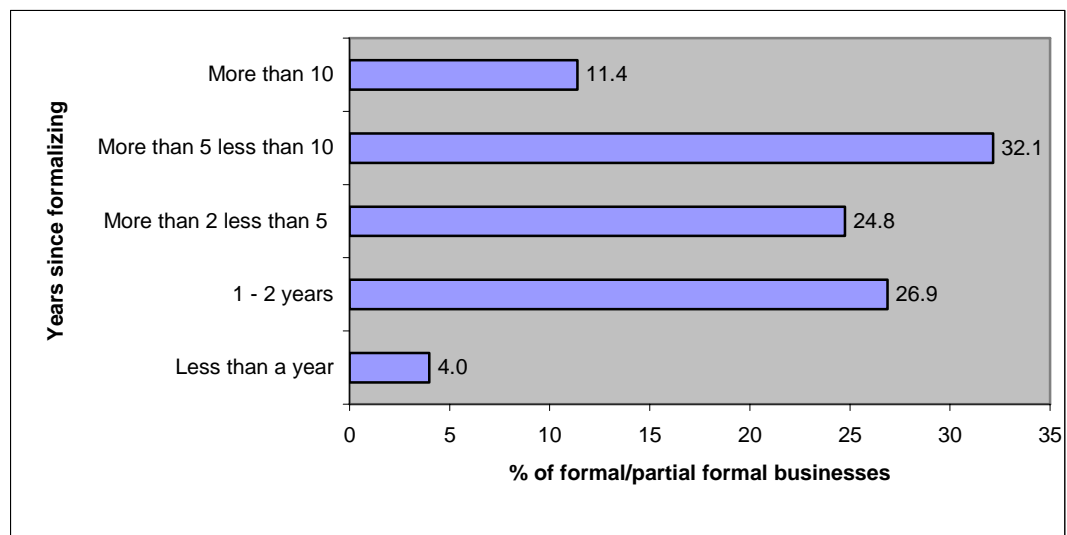
The main assets owned by businesses surveyed include land and premises.

Most firms that own assets operate at a level higher than the region, in the construction sector, and are in the Southern and Eastern regions. About 15% of businesses do not own any assets, of which over 13% are completely informal, and over 15% formal/partially formal. Most of these businesses are in the Western Area.

Informality related characteristics

The analysis reveals that formal/ partially formal businesses first formalized between 1-10 years prior to the survey (see Figure 3). The majority of businesses that did formalize within the last 1-2 years – that is, provided information to one or more government agency – are those with less than 3 workers, concentrated in the Eastern region, and proportionately higher within the trade and services sectors. The majority that formalized between 5-10 years ago were in businesses with more than 4 workers, in the Western Area and Southern regions, and higher within the construction, agriculture and manufacturing sectors.

Figure 3. Years since Formalizing

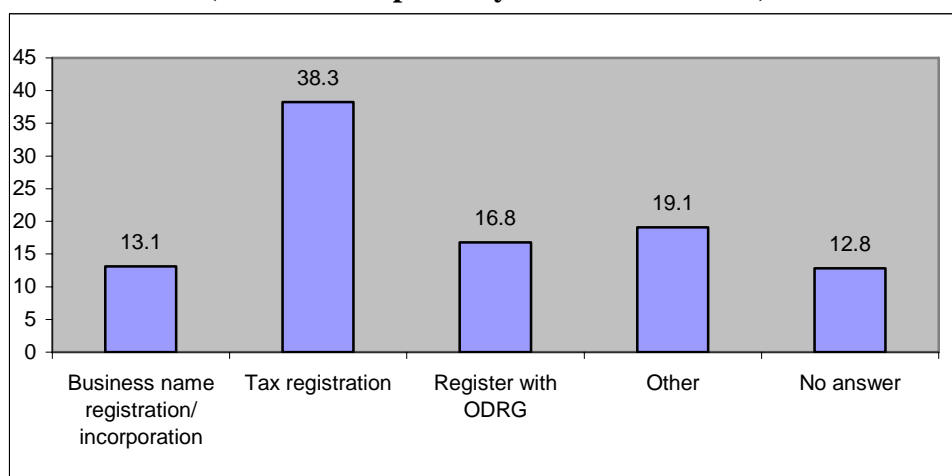


Most formal/partially formal businesses in the survey formalized through tax registration, particularly those that operate at the Chiefdom level. More businesses that operate at a level higher than the region formalized through business name registration/incorporation. Businesses in the Eastern and Northern regions mainly formalized (65% and 36% respectively) through tax registration.

In the Western Area, most businesses formalized through registration with the Office of Administration and Registrar General (ODRG).

Overall, about 17% of businesses formalized through the ORDG. According to the Census of Business Establishments (2005) of over 10,000 businesses, 14% of all establishments interviewed were registered with the ORDG.

**Figure 4. Steps through which Businesses Formalized
(% of formal/partially formal businesses)**



According to the majority of community leaders (over 50%), the shares of unregistered businesses in their communities is between 40-80%. In the Eastern Region, which is dominated by agricultural activity, over 40% of community leaders believe that more than 80% of businesses are unregistered.

This finding is also consistent with the Census of Business Establishments (2005) which reports that 66% of business establishments were ‘Not Registered’ establishments (i.e. with any government agency).

Table 3. Percentage of unregistered (completely informal) businesses in community

			Region				
			Total	Western Area	Southern Region	Northern Region	Eastern region
Percentage of unregistered businesses in community	Up to 20%	%	13.3	0.0	39.5	0.0	9.8
	21% - 40%	%	12.6	17.2	7.9	0.0	24.4
	41% - 60%	%	33.6	51.7	36.8	34.3	17.1
	61% - 80%	%	25.2	27.6	10.5	60.0	7.3
	81% - 100%	%	14.0	3.4	0.0	5.7	41.5
	No answer	%	1.4	0.0	5.3	0.0	0.0
Total	N	143	29	38	35	41	
Mean		55.9	57.9	35.6	65.9	63.7	

Indications of the size of informal activity can also be gauged from the formality status of competitors. The majority of businesses (60%) claim to have between 5-15 direct competitors. In relation to formality status of competitors, about 30% of completely informal businesses have no formal competitors, while only about 7% have over 50% formal competitors. On the other hand, only over 6% of formal/partially businesses have no formal competitors, and 35% have over 50% formal competitors. In the Southern Region, as much as 50% of all businesses surveyed claim to have no formal competitors. In addition, almost 40% of agricultural businesses surveyed have no formal competitors.

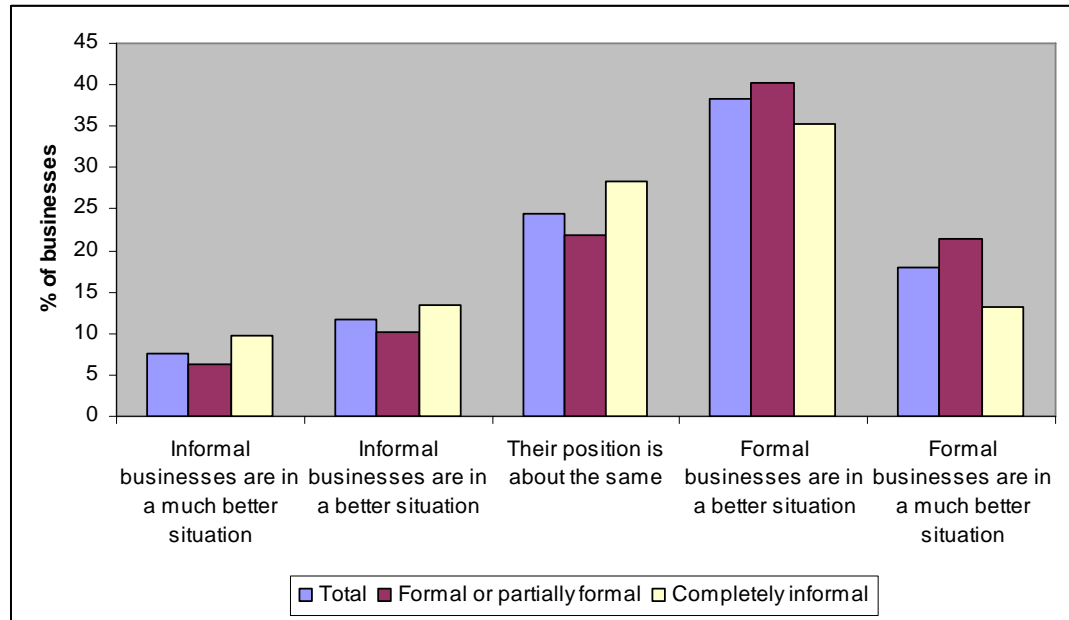
Advantages and Disadvantages of Informality

Advantages of Informality

The survey shows that the majority of respondents perceive that it is more advantageous to operate as a formal business. As such, over 56% of businesses believe formal businesses are in a better or much better situation than their informal counterparts (see Figure 5). This is especially the case for smaller businesses, and those that operate at the Chiefdom level.

On the other hand, almost 20% of businesses consider that informal firms are more advantaged, and this view is relatively more prominent amongst completely informal businesses. Regional differences also arise, where proportionately more businesses in the Southern region perceive that formal businesses are in a much better situation, in contrast to the Northern Region in particular.

Figure 5. Situation of Formal and Informal Businesses



The main perceived advantages of informality are the avoidance of licensing problems, labor taxes and contributions, and income/profit tax. The majority of businesses consider that the three main advantages of informality include no licensing problems (51% of businesses), no labor taxes and contributions (47%), no income/profit tax (43%), and avoidance of labor regulations/more flexible work (31%), amongst others (see Table 4). Relatively more formal/partially formal businesses regard these as the key advantages of informality as compared to completely informal firms. On the other hand, it is interesting to note that compared to formal/partially formal businesses, more completely informal firms find that the three main advantages include access to the ‘black market’ and lower administrative cost.

Smaller businesses are relatively more burdened by licensing and taxes, as well as administrative costs. Administrative costs are a particular issue (as reflected by perceptions of advantages in avoiding) for businesses in the trade sector, and in the Northern and Southern regions.

Table 4. Three most important advantages of being informal

		Formality status			
		Total	Formal or partially formal	Completely informal	
Advantages of being informal	Avoidance of labor regulations/more flexible work force	%	31.3	38.3	23.8
	No labor taxes and contributions	%	46.8	49.4	44.0
	No product standards	%	18.6	20.6	16.5
	No licensing problems	%	51.4	54.6	48.0
	No health/safety inspections	%	17.5	20.5	14.4
	No income/profit tax	%	43.0	45.5	40.2
	Easier/cheaper access to raw materials	%	10.6	10.2	11.1
	No price controls on products	%	19.2	22.0	16.1
	Access to 'black market'	%	19.8	15.5	24.3
	Cheaper price for utilities	%	6.3	7.1	5.5
	Access to cheap 'informal' land	%	2.3	2.7	1.8
	Lower admin costs	%	10.1	8.8	11.5
	Other	%	0.1	0.3	0.0
	No advantage whatsoever	%	0.1	0.3	0.0
	No answer	%	2.9	0.1	5.8
Total	Responses	3,814	2,081	1,733	
	N	1,362	703	659	

Base: All respondents. Note: This is a multiple option answer - sum of percentages may exceed 100

In terms of the most important advantage of informality, almost 45% of businesses (in particular formal/partially formal) consider this to be labor-related i.e. the avoidance of labor taxes/contributions and avoidance of labor regulations/flexibility of labor. As much as 70% of businesses in the construction industry hold this view, which reflects the high informal labor typically employed in this sector. Labor constraints are also relatively considered more important in the Western Area. Labor issues are followed by licensing and tax issues as the main advantage to be informal.

The key factors behind the most important advantage of remaining informal are absence of information, financial burden, and administration. For formal/partially formal businesses, the main aspects behind the most important advantage of informality are: the absence of effort to find information (66% of businesses), financial burden of being formal (62%), and lack of enforcement (59%). For completely informal businesses, the main aspects are: absence of effort to find information (58%), followed by financial burden (52%) and – in contrast to the view of formal/partially formal businesses – avoiding harassment by public officials (49%).

For all businesses, these aspects generally take more prominence as the level of operation of the business increases, except for lack of enforcement which is more important for businesses that operate at the Chiefdom level. In addition, smaller-sized businesses also find these aspects more significant. The lack of effort to find information is particularly important in the Northern and Eastern regions (as well as lack of enforcement in the latter), and dealing with public officials and financial burden in the Western Area.

Table 5. Factors behind main advantage of Informality

		Formality status		
		Total	Formal or partially formal	Completely informal
Aspects of informality advantages	Absence of effort to find info %	62.3	66.1	58.1
	No dealing with legal requirements %	39.6	45.5	33.2
	No dealing with tyranny of public officers %	50.6	51.9	49.2
	Lack of enforcement %	50.7	58.9	41.9
	Financial burden %	56.8	61.6	51.6
	Don't know %	27.9	25.0	31.0
	Total Responses	3,919	2,173	1,746
	N	1,362	703	659

Disadvantages of Informality

The three most important disadvantages of informality are considered to be limited access to finance, the need to pay bribes to avoid formal procedures, and the fear of government retribution. Relatively more businesses that are completely informal find that both lack of access to the broader market and access/price of utilities are amongst the key disadvantages than their more formal counterparts. The need to pay bribes to sustain informal status and the fear of government retribution are more important disadvantages for smaller businesses, and for those in the Eastern region. Limited access to finance is a more important disadvantage in the Western Area and Northern Region compared to other regions.

Table 6. Three most important disadvantages of being Informal

			Formality status		
			Total	Formal or partially formal	Completely informal
Disadvantages of being informal	Limited access to finance	%	63.4	63.7	63.0
	Limited access to raw materials	%	24.3	25.3	23.2
	Need to pay bribes to avoid 'formal'	%	38.9	45.2	32.2
	No access to and insecurity of premises/land/legal rights	%	17.8	20.6	14.7
	Large labor turnover/limited skills	%	9.5	11.1	7.9
	Inability to sell to/buy from formal enterprises (wholesale)	%	19.7	20.6	18.7
	Theft by employees/suppliers/buyers	%	15.3	19.5	10.9
	Fear of government retribution (formal or informal)	%	28.4	34.6	21.9
	No access to and price of utilities	%	11.6	5.5	18.1
	No access to broader market	%	24.7	22.6	27.0
	No tax reclaims	%	12.2	12.4	12.0
	Other (please specify)	%	1.7	2.3	1.1
	No disadvantages whatsoever	%	1.5	2.3	0.6
	No answer	%	3.9	1.3	6.7
	Total	Responses	3,717	2,018	1,699
	N	1,362	703	659	

Base: All respondents. Note: This is a multiple option answer - sum of percentages may exceed 100

The most important perceived disadvantage is again, limited access to finance (45% of businesses), or bribes (16%), or limited access to raw materials (7.4%), or fear of government retribution (6.8%).

Direct Costs of Informality

One-fifth of businesses surveyed incurred some payment over the previous one year to sustain their informal status. The cost of maintaining an informal business was on average about 20% of sales over the last year. In terms of amount, the average payment incurred was SL 1,062,224 or about US\$450, while the median payment was SL 80,000 or about US\$35. The average payments are higher for businesses operating at the Chiefdom level, particularly in terms of sales. As much as 60% of businesses also admit to having incurred other 'burdens' in order to operate informally. This 'cost' was experienced by 73% of businesses that operate only at the Chiefdom level.

These 'payments' are most experienced by businesses in the Eastern Region and Western Area. In the Western Area, for example, 42% of businesses incurred expenses to sustain their informal status over the previous year, and 75% faced 'other burdens'.

Less female respondents incurred 'costs' compared to males, but more had 'other burdens'. Though less female respondents incurred costs, these were about five times the mean 'costs' compared to males, amounting to SL 2,624,581 (US\$1,116) compared to SL 512,825 (US\$218) for males. This is very high given that Sierra Leone's GNI per capita is US\$200. However, as a percent of sales, females paid about the same as males (21% compared to 20% for males). This

suggests higher sales levels of female businesses. Also, as much as 68% of female respondent faced ‘other burdens’ compared to 58% of males.

At the sectoral level, more businesses in the manufacturing sector (31%) incurred expenses to operate informally than other sectors. However, the mean ‘costs’ were highest in trade, and the median ‘costs’ highest in services. Other burdens were highest in the manufacturing and agricultural sectors.

Table 7a. Financial Costs and other burdens to sustain Informal Status by Level of Operations

			Level of operations				
			Total	Chiefdom	District	Higher than region	No answer
Costs for sustaining informal status	Yes	%	21.5	23.0	17.4	24.1	6.7
	No	%	78.5	77.0	82.6	75.9	93.3
	Total	N	659	417	144	83	15
Costs for sustaining informal status - LCU	Mean		1,062,224	1,374,805	800,552	54,105	80,000
	Median		80,000	90,000	98,000	25,000	80,000
Costs for sustaining informal status - % of sales	Mean		20.5	24.2	16.1	11.4	10.0
	Median		20	20	10	5	10
Other burdens to sustain informality	Yes	%	60.6	72.9	36.0	35.0	0.0
	No	%	39.4	27.1	64.0	65.0	100.0
	Total	N	142	96	25	20	1

Base: Completely informal businesses

Table 7b. Financial Costs and other burdens to sustain Informal Status by Sector

			Sector						
			Total	Manufacturing	Trade	Services	Agriculture	on	No answer
Costs for sustaining informal status	Yes	%	21.5	31.3	19.4	28.1	15.3	14.3	25.0
	No	%	78.5	68.8	80.6	71.9	84.7	85.7	75.0
	Total	N	659	48	355	139	98	7	12
Costs for sustaining informal status - LCU	Mean		1,062,224	569,217	1,624,407	693,833	69,615		700,000
	Median		80,000	90,000	75,000	100,000	65,000		80,000
Costs for sustaining informal status - % of sales	Mean		20.5	22.8	19.5	22.1	21.2	15.0	9.0
	Median		20	20	20	20	15	15	10
Other burdens to sustain informality	Yes	%	60.6	73.3	59.4	59.0	73.3	0.0	0.0
	No	%	39.4	26.7	40.6	41.0	26.7	100.0	100.0
	Total	N	142	15	69	39	15	1	3

Base: Completely informal businesses

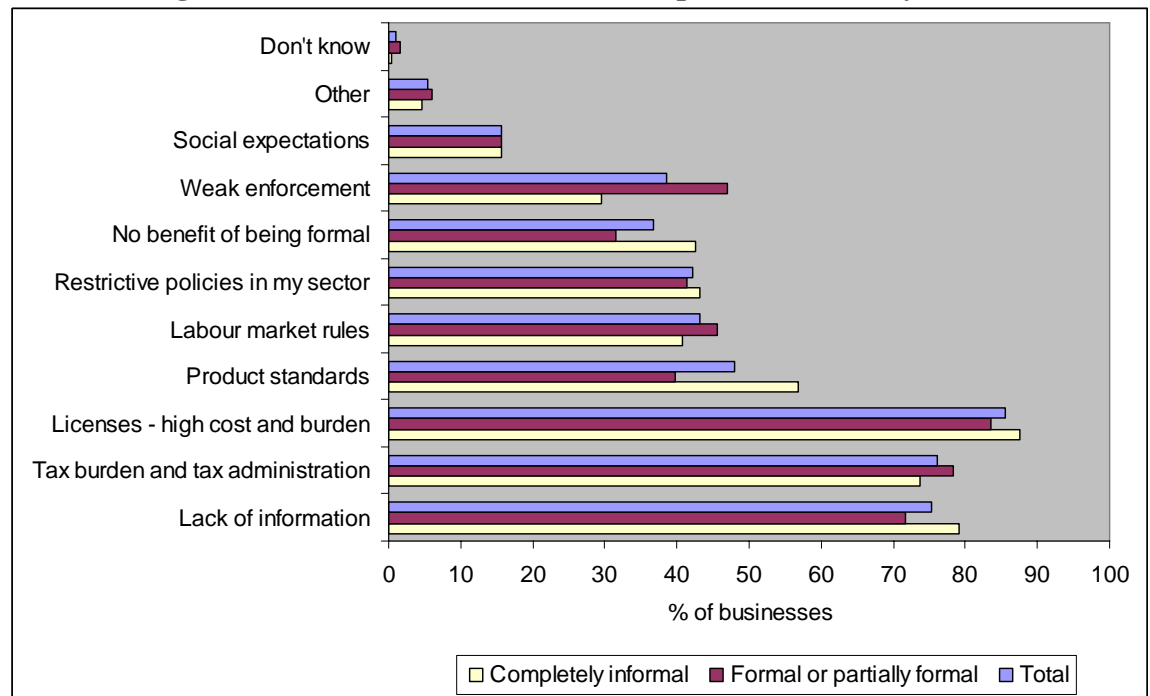
Reasons for Informality and Government incentives that would stimulate formality

Reasons for Informality

Businesses decide to operate informally due to licensing and tax issues, and lack of information. The survey revealed the majority of businesses (86%) believe that the high cost and burden of licenses is the most important issue that holds back informal businesses from complying with all necessary government requirements. Other key reasons are tax burden and administration (76% of businesses) and lack of information (75%). More completely informal businesses consider the lack of information as a key reason as compared to formal/partially

formal businesses. This aspect is also more considered more significant for businesses that are smaller in size and that operate at the Chiefdom level, particularly in the Southern and Northern regions. Aspects related to licenses, taxes, labor market restrictions, and product standards are significant for more businesses that operate at the District level. As much as 66% of businesses in the Northern Region believe that firms operate informally because they see no benefit of being formal.

Figure 6. Reasons behind decision to operate Informally



Formalizing completely informal businesses

The majority of completely informal businesses are not well informed about the necessary steps to become fully formal. About 36% of completely informal businesses know nothing the procedures for formalization in their area of business, and another 40% only know a few details. Businesses that know nothing about the steps are relatively smaller, operate more at the Chiefdom level, in the construction and agricultural sectors, and in the Southern and Northern regions. In addition, more female respondents (41%) knew nothing about steps compared to their male counterparts (33%). On the other hand, only about 7% of the businesses surveyed are relatively well informed or know exactly what steps are required to become formal. These businesses are relatively more in the Eastern and Western regions.

Table 8. Personal Knowledge about steps to become Formal

			Region				
			Total	Western Area	Southern Region	Northern Region	Eastern region
Personal knowledge about steps to become formal	Know nothing	%	35.8	13.6	52.8	43.0	27.8
	Know few details	%	39.1	52.1	26.4	44.0	28.9
	Know something	%	18.4	26.0	16.9	9.0	27.8
	Relatively well informed	%	5.8	5.9	3.4	3.5	15.6
	Know exactly	%	0.9	2.4	0.6	0.5	0.0
	Total	N	637	169	178	200	90
		Missing	725	148	171	175	231
	Mean	1.97	2.31	1.72	1.75	2.31	

Base: Completely informal businesses

Over one-quarter of completely informal businesses have attempted to become formal. About 27% of businesses have tried to formalize by at least actively collecting necessary information about the required procedures. This is particularly the case for larger business, businesses that operate at the District level, and in the Eastern and Western regions. More businesses in the manufacturing sector (35%) tried to become formal. Over 30% of male respondents tried to formalize their businesses compared to 22% of females.

Table 9a. Attempt to Formalize by Size

			Size of the company				
			Total	3 and less	4 - 10	More than 10	No answer
Ever tried to become formal	Yes	%	27.2	25.2	27.7	43.2	42.9
	No	%	72.8	74.8	72.3	56.8	57.1
	Total	N	659	424	191	37	7

Base: Completely informal businesses

Table 9b. Attempt to Formalize by Location

			Region				
			Total	Western Area	Southern Region	Northern Region	Eastern region
Ever tried to become formal	Yes	%	27.2	34.4	20.0	20.2	42.2
	No	%	72.8	65.6	80.0	79.8	57.8
	Total	N	659	186	180	203	90

Base: Completely informal businesses

Table 9c. Attempt to Formalize by Sector

			Sector						
			Total	Manufacturing	Trade	Services	Agriculture	Construction	No answer
Ever tried to become formal	Yes	%	27.2	35.4	27.9	27.3	20.4	28.6	25.0
	No	%	72.8	64.6	72.1	72.7	79.6	71.4	75.0
	Total	N	659	48	355	139	98	7	12

Base: Completely informal businesses

Businesses that tried to formalize failed because the procedures were too expensive, complicated and they lacked the information. Over 27% of completely informal businesses failed in their attempt to come formal because the steps were too costly, 26% due to complicated steps, and 22% because they were unable to find all necessary information. Interestingly, more businesses that are larger in size could not find the necessary information – 38% of businesses with more than 10 workers compared to 18% of those with 3 and less workers. The lack of information was particularly experienced by businesses (50%) in the Southern region and by those in the agricultural sector (50% of businesses). The cost of procedures was an impediment for more businesses (45%) in the Western Area, and in the manufacturing and construction sectors.

Table 10. Reasons for failure in attempt to become formal by location

			Region				
			Total	Western Area	Southern Region	Northern Region	Eastern region
What stopped you	Couldn't find all necessary	%	22.3	15.6	50.0	19.5	10.5
	The steps are too complicated	%	25.7	14.1	27.8	36.6	31.6
	The steps are too expensive	%	27.4	45.3	13.9	26.8	10.5
	Couldn't comply with all necessary	%	8.4	15.6	2.8	9.8	0.0
	My application was rejected	%	0.6	1.6	0.0	0.0	0.0
	The process got interrupted/stuck and I don't know why	%	6.7	3.1	2.8	0.0	23.7
	Other	%	7.3	3.1	2.8	2.4	23.7
	No answer	%	1.7	1.6	0.0	4.9	0.0
	Total	N	179	64	36	41	38

Base: Completely informal businesses

Most completely informal businesses surveyed are likely to consider becoming formal over the next two years. About 75% of businesses may/probably will consider formalization in the next two years, while 7% are almost certain to formalize. Chances of formalization are higher the larger the businesses. Businesses are less likely to formalize in the Southern and Northern regions, and in the agricultural and construction sectors. Female respondents are also less likely to formalize.

Table 11. Probability of Formalization over next two years by size of business

			Size of the company				
			Total	3 and less	4 - 10	More than 10	No answer
Chances to become formal	Absolutely no chance	%	9.9	9.4	11.5	5.4	14.3
	Not very probable	%	7.6	6.8	10.5	2.7	0.0
	Maybe	%	44.5	46.2	39.8	48.6	42.9
	Probably	%	31.4	31.8	30.4	35.1	14.3
	Almost sure	%	6.7	5.7	7.9	8.1	28.6
	Total	N	659	424	191	37	7

Factors that have pushed businesses to consider formalizing include increased information availability, high cost of 'payments' to maintain informal status, and high official penalties. The majority of businesses (56%) would seriously consider becoming formal if information on the procedures required became more freely available. This is particularly the case for businesses that operate at the Chiefdom level (62%) and in the Southern Region (90% of businesses). Amongst other inducements cited by many businesses were the high bribes for maintaining the informal status (51% of businesses), high official penalties (47%), and plans to expand the business (42%). About 37% of businesses would formalize if tax rates/administration was improved, and 34% if administrative barriers were reduced. All of these factors are more prominent for businesses in the manufacturing sector, and for those that operate at the Chiefdom level. More female respondents (64%) would be motivated by these factors than males (52%).

Table 12. Reasons for seriously considering becoming Formal by level of operation

		Level of operations					
		Total	Chiefdom	District	Higher than region	No answer	
Stimulation to become more formal	Information became available	%	56.2	62.3	37.3	48.0	75.0
	Taxes not that high/ tax admin fair	%	37.5	37.7	33.3	36.0	62.5
	High bribes for maintaining informality	%	51.0	58.7	25.5	44.0	75.0
	High penalties (official)	%	47.4	56.9	27.5	20.0	62.5
	Reduced admin burdens	%	33.5	35.9	21.6	32.0	62.5
	Cannot operate informally anymore/ gov't pressures	%	33.9	40.7	15.7	20.0	50.0
	I want to expand	%	42.2	44.9	25.5	56.0	50.0
	Better access to customers and suppliers	%	41.4	51.5	15.7	32.0	25.0
	Better access to finance	%	35.9	41.3	21.6	32.0	25.0
	Better access to gov't services	%	30.3	40.1	11.8	8.0	12.5
	Incentives from gov't	%	10.4	11.4	7.8	12.0	0.0
	Recent labour reform	%	3.2	4.2	2.0	0.0	0.0
	Other	%	1.6	2.4	0.0	0.0	0.0
	Don't know	%	27.5	18.6	51.0	44.0	12.5
	Total	Respo	1,134	846	151	96	41
		N	251	167	51	25	8

Base: All respondents. Note: This is a multiple option answer - sum of percentages may exceed 100

Most businesses state that the single biggest factor for seriously considering becoming formal is high official penalties, closely followed by access to information. In addition, better access to finance is also considered the most important reason for many businesses (9%).

Respondents that stated few chances of considering formalization would reconsider their stance if the government provided incentives such as reduced taxes. Government measures that would act as incentives to become formal include reduced taxes (88% of businesses), increased transparency of all procedures especially start-up requirements (69%), tax incentives (60%) and reduced administrative barriers (60%). Tax-related incentives are more important for businesses in the Western Area and Northern Region. Increased transparency and reduced administrative barriers are significant for relatively more businesses in Southern and Northern regions (both about 70% of businesses).

Table 13. Incentives that would increase chances for becoming Formal by Sector

		Sector							
		Total	Manufacturing	Trade	Services	Agriculture	Construction	No answer	
Government measures that would stimulate formality	Increased transparency	%	69.1	75.8	70.9	66.2	62.3	100.0	57.1
	Tax incentives	%	60.1	51.5	61.0	66.2	55.1	20.0	85.7
	Reduced taxes	%	87.9	84.8	87.3	85.7	94.2	80.0	85.7
	Increased costs of informality	%	37.9	42.4	42.3	40.3	21.7	20.0	28.6
	Reduced admin burdens	%	59.7	57.6	55.9	61.0	71.0	60.0	57.1
	Increased gov't pressure	%	30.2	27.3	34.3	35.1	17.4	20.0	0.0
	More transparent admin requirements	%	42.3	39.4	46.5	39.0	31.9	80.0	42.9
	Reduced cost of labour/ less restrictive labour policies	%	30.7	30.3	31.0	33.8	30.4	20.0	0.0
	Other	%	5.4	3.0	7.0	0.0	4.3	20.0	28.6
	Don't know	%	0.7	0.0	0.9	1.3	0.0	0.0	0.0
	Total	Respo	1,713	136	931	330	268	21	27
		N	404	33	213	77	69	5	7

Base: All respondents. Note: This is a multiple option answer - sum of percentages may exceed 100

Other areas that would improve the chances of formalization include better access to loans and availability of raw materials. In addition to the factors listed in the Table 12 above, 43% of businesses would be influenced to become formal if they had better access to loans, and better availability of raw materials, in particular in the Southern Region (67% of businesses in the region) and in the services sector. Business expansion/ improvement were cited by 20% of businesses as another reason for increasing the possibility of their formalization, especially in the agriculture and construction sectors.

Ex-informal Businesses

Half the businesses surveyed operated in the informal sector before moving to the formal sector. About 45% of formal or partially formal businesses in the survey operated informally for a while before becoming formal. More smaller-sized businesses (3-10 workers) once operated informally. Almost 60% of businesses in manufacturing and 55% in construction were previously informal.

Table 14. Businesses operating informally before formalizing by Sector

			Sector						
			Total	Manufacturing	Trade	Services	Agriculture	Construction	No answer
Operated as informal before	Yes	%	45.1	58.9	42.1	44.7	45.7	53.8	50.0
	No	%	54.9	41.1	57.9	55.3	54.3	46.2	50.0
	Total	N	703	73	435	103	35	13	44

Base: Formal or partially formal businesses

The key reasons that pushed businesses to the formal sector were information availability, business expansion, high costs to maintain informal status, and a better tax system. Over 70% of businesses became formal because information on the required procedures became available (80% of manufacturing businesses). As many businesses became formal because they wanted to expand (88% of businesses in the agricultural sector). Businesses (67%) were also forced to formalize due to high penalties, shutdown expenses and other expenses to sustain informality (except bribes/informal payments) – in particular for those operating in the agricultural sector and at the Chiefdom level. Over 60% realized that taxes are not that high and the administration is fair. Taxes and business expansion were significant factors for businesses with more than 10 workers. More businesses in the Northern Region were influenced by the factors listed. However, high bribes to sustain informality were a primary factor in the Western Area.

Table 15a. Reasons for stimulating ex-informal businesses to formality by Size

			Size of the company				
			Total	3 and less	4 - 10	More than 10	No answer
Reasons for becoming more formal	Information became available	%	71.6	69.3	76.3	70.6	100.0
	Taxes not that high/ tax admin fair	%	61.8	58.9	67.0	70.6	0.0
	High bribes to sustain informality	%	53.6	50.0	58.8	64.7	100.0
	High penalties to sustain informality	%	66.6	65.8	67.0	76.5	0.0
	Admin burdens reduced	%	45.7	42.6	51.5	52.9	0.0
	Could not operate due to gov't pressure	%	55.2	56.9	51.5	58.8	0.0
	I wanted to expand	%	69.4	71.8	61.9	82.4	100.0
	Better access to customers and suppliers	%	55.2	54.5	56.7	58.8	0.0
	Better access to finance	%	48.9	46.0	48.5	82.4	100.0
	Better access to gov't services	%	29.7	30.2	25.8	47.1	0.0
	Incentives from gov't	%	15.5	13.4	16.5	35.3	0.0
	Labour reform	%	5.4	5.0	5.2	11.8	0.0
	Other	%	0.3	0.5	0.0	0.0	0.0
	Don't know	%	1.3	2.0	0.0	0.0	0.0
	Total	Respo	1,839	1,145	569	121	4
		N	317	202	97	17	1

Base: Formal or partially formal businesses. Note: This is a multiple option answer - sum of percentages may exceed 100

Table 15b. Reasons for stimulating ex-informal businesses to formality by Sector

			Sector						
			Total	Manufacturing	Trade	Services	Agriculture	Construction	No answer
Reasons for becoming more formal	Information became available	%	71.6	79.1	73.8	58.7	75.0	71.4	63.6
	Taxes not that high/ tax admin fair	%	61.8	72.1	62.3	39.1	62.5	57.1	86.4
	High bribes to sustain informality	%	53.6	51.2	55.7	54.3	93.8	14.3	22.7
	High penalties to sustain informality	%	66.6	76.7	60.7	65.2	81.3	57.1	90.9
	Admin burdens reduced	%	45.7	51.2	44.3	34.8	50.0	57.1	63.6
	Could not operate due to gov't pressure	%	55.2	65.1	50.8	58.7	56.3	14.3	77.3
	I wanted to expand	%	69.4	69.8	65.6	71.7	87.5	57.1	86.4
	Better access to customers and suppliers	%	55.2	65.1	48.6	65.2	56.3	14.3	81.8
	Better access to finance	%	48.9	46.5	44.8	50.0	75.0	42.9	68.2
	Better access to gov't services	%	29.7	51.2	21.9	34.8	43.8	0.0	40.9
	Incentives from gov't	%	15.5	37.2	7.7	8.7	25.0	0.0	50.0
	Labour reform	%	5.4	20.9	1.6	2.2	0.0	0.0	18.2
	Other	%	0.3	0.0	0.0	2.2	0.0	0.0	0.0
	Don't know	%	1.3	2.3	1.6	0.0	0.0	0.0	0.0
	Total	Respo	1,839	296	987	251	113	27	165
		N	317	43	183	46	16	7	22

Base: Formal or partially formal businesses. Note: This is a multiple option answer - sum of percentages may exceed 100

Community Leader perceptions

According to the community leaders surveyed, the main reason businesses do not report their activity to the government is to avoid licensing and tax problems. Amongst the reasons cited by at least half of community leaders for not formalizing are: avoidance of licensing and taxes, price controls on products, access to black market, avoidance of labor regulations and taxes, and avoidance of product standards. Lack of health and safety inspections are also cited by 45% of community leaders.

Table 16. Reasons for not formalizing: perceptions of Community Leaders

			Region				
			Total	Western Area	Southern Region	Northern Region	Eastern region
Reasons for not formalizing	Avoidance of labor regulations/more flexible work force	%	49.7	58.6	86.8	5.7	46.3
	No labor taxes/social security contributions	%	48.3	41.4	86.8	5.7	53.7
	No product standards	%	48.3	34.5	89.5	37.1	29.3
	No problems related to licensing	%	59.4	24.1	100.0	57.1	48.8
	No health/safety inspections	%	45.5	31.0	94.7	5.7	43.9
	No income/profit taxes	%	54.5	31.0	100.0	5.7	70.7
	Easier/cheaper access to raw materials	%	39.2	31.0	55.3	31.4	36.6
	No price controls on products	%	55.2	37.9	81.6	42.9	53.7
	Access to "black market"	%	51.7	17.2	55.3	74.3	53.7
	Cheaper price for utilities	%	24.5	10.3	47.4	5.7	29.3
	Access to cheap "informal" land	%	18.9	6.9	42.1	2.9	19.5
	Lower administrative costs for procedures	%	28.0	10.3	42.1	28.6	26.8
	DK/NA	%	6.3	17.2	0.0	0.0	9.8
	Total	Respo	757	102	335	106	214
	N	143	29	38	35	41	

Base: Community Leaders. Note: This is a multiple option answer - sum of percentages may exceed 100

Government measures that would stimulate formalization include better access to information and reduction of administrative barriers in general. About 70% of community leaders surveyed believe that increased availability of information would help businesses formalize (97% in the Southern Region). As many community leaders perceive that reduction of administrative barriers would provide incentives to formalize. Lower taxes are considered a stimulant by all community leaders in the Southern Region. In terms of the *most* important measure to increase formalization, almost 50% of all community leaders consider this to be improving access to finance.

Table 17. Measures that would stimulate formalizing

			Region				
			Total	Western Area	Region	Northern Region	Eastern region
Stimulating government measures	Better access to the information	%	70.1	76.0	97.4	17.6	85.0
	Lower taxes	%	65.0	64.0	100.0	8.8	80.0
	Less rigid and more friendly tax administration	%	68.6	44.0	76.3	73.5	72.5
	Increasing penalties for informal businesses	%	33.6	12.0	65.8	8.8	37.5
	Reduction of admin burdens in general	%	69.3	64.0	65.8	73.5	72.5
	Increasing pressure on informal businesses	%	31.4	12.0	63.2	2.9	37.5
	Improving access to customers and suppliers	%	55.5	44.0	78.9	44.1	50.0
	Improving access to finance	%	59.9	24.0	97.4	14.7	85.0
	Improving government services (police, courts,...)	%	31.4	28.0	63.2	8.8	22.5
	Incentives for new businesses	%	46.0	16.0	92.1	20.6	42.5
	Less rigid, complicated and less expensive labor regulation	%	23.4	12.0	28.9	0.0	45.0
	Total	Respo	759	99	315	93	252
		N	137	25	38	34	40

Base: Community Leaders. Note: This is a multiple option answer - sum of percentages may exceed 100

The following sub-sections (4-8) describe survey results for informality related to licensing, product standards, land, labor and tax. These results are based on responses from formal/partially formal businesses.

Licensing Informality

Most formal/partially formal respondents claim to comply with licensing requirements. Almost 10% of formal/partially formal respondents do not possess the specific licenses that are required in their area of operation, and another 5% state that they do not require licenses to operate. More businesses with lower levels of operation claim to not possess licenses or not need licenses than those operating at higher levels (10% of businesses at Chiefdom level compared to 5% at higher than region level). In addition, one-quarter of larger-sized businesses (more than 10 workers) suggest that they do not require licenses to operate, compared to less than 4% of businesses with less than 3 employees.

More businesses in the Northern Region (16%) do not possess required licenses compared to other regions (7% or less). Relatively more businesses in the construction sector (15%) do not have the needed licenses. In the agricultural sector, almost 40% of businesses claim to not need licenses to operate.

Table 18. Possession of required licenses by sector

			Sector						
			Total	Manufacturing	Trade	Services	Agriculture	Construction	No answer
Licenses possession	Yes	%	85.8	86.3	89.4	88.3	62.9	84.6	61.4
	No	%	8.8	8.2	7.1	8.7	0.0	15.4	31.8
	No license needed	%	4.8	5.5	2.8	2.9	37.1	0.0	4.5
	No answer	%	0.6	0.0	0.7	0.0	0.0	0.0	2.3
	Total	N	703	73	435	103	35	13	44

Base: Formal or partially formal businesses

High licensing costs, requirements, and lack of information are cited as reasons for businesses not possessing all necessary licenses. About 80% of formal/partially formal businesses state that the reasons for not having required licenses – either themselves or competitors – are high costs and requirements for obtaining licenses. This is substantiated by the Doing Business results which show the number of procedures required to comply with licensing is substantially more than the region (see Box 6).

Almost 70% cite lack of information on licensing requirements. These three reasons – licensing costs, requirements and lack of information – are prominent for more businesses in the agricultural sector than other sectors (see Table 19). For businesses that operate at a level higher than the region (60%) and in the Northern region (75%), weak enforcement is a more important reason than for those that operate at lower levels and in other regions.

Table 19. Reasons for not acquiring required licenses by sector

		Sector							No answer
		Total	Manufacturing	Trade	Services	Agriculture	Construction		
Reasons not to get license	Lack of information	67.4	78.3	62.4	69.0	95.5	69.2	80.5	
	High costs	82.9	81.2	84.0	76.0	90.9	76.9	87.8	
	High requirements	79.1	76.8	79.5	77.0	86.4	76.9	80.5	
	Unclear policy	48.0	50.7	45.0	47.0	45.5	38.5	80.5	
	Nobody has it why	23.0	24.6	18.6	21.0	27.3	23.1	68.3	
	Weak enforcement	51.1	50.7	49.5	52.0	63.6	30.8	65.9	
	Misuse of power by	41.1	49.3	37.9	38.0	40.9	30.8	70.7	
	Process too long	32.5	31.9	32.9	29.0	36.4	38.5	34.1	
	Other	9.2	5.8	10.2	11.0	9.1	7.7	0.0	
	Don't know	3.3	0.0	3.3	7.0	0.0	7.7	0.0	
Total	2,909	310	1,778	427	109	52	233		
N	665	69	420	100	22	13	41		

Base: Formal or partially formal businesses. Note: This is a multiple option answer - sum of percentages may exceed 100

Businesses that do not possess required licenses (around 40% of these businesses) also state reasons such not realizing the need since others do not possess a license, unclear policy, misuse of power by licensing officials, and too long a process for obtaining a license.

Table 20. Actual and Perceived reasons for not acquiring required licenses

			Licenses possession		
			Total	Yes	No
Reasons not to get license	Lack of information	%	67.4	67.3	67.7
	High costs	%	82.9	83.9	72.6
	High requirements	%	79.1	79.4	75.8
	Unclear policy	%	48.0	48.6	41.9
	Nobody has it why should I	%	23.0	21.6	37.1
	Weak enforcement	%	51.1	50.6	56.5
	Misuse of power by public officers	%	41.1	40.8	43.5
	Process too long	%	32.5	32.0	37.1
	Other	%	9.2	9.6	4.8
	Don't know	%	3.3	2.5	11.3
Total	Responses	2,909	2,631	278	
N		665	603	62	

Base: Formal or partially formal businesses. Note: This is a multiple option answer - sum of percentages may exceed 100

Box 6. Dealing with Licenses in Sierra Leone

The steps, time, and costs of complying with licensing and permit requirements for ongoing operations in Sierra Leone are shown below. It takes **48** steps and **236** days to complete the process, and costs **268.9%** of income per capita.

Indicator	Sierra Leone	Region	OECD
Procedures (number)	48	20.1	14.1
Time (days)	236	251.5	146.9
Cost (% of income per capita)	268.9	1,597.3	75.1

Source: Doing Business, 2005, World Bank.

Product Standards Informality

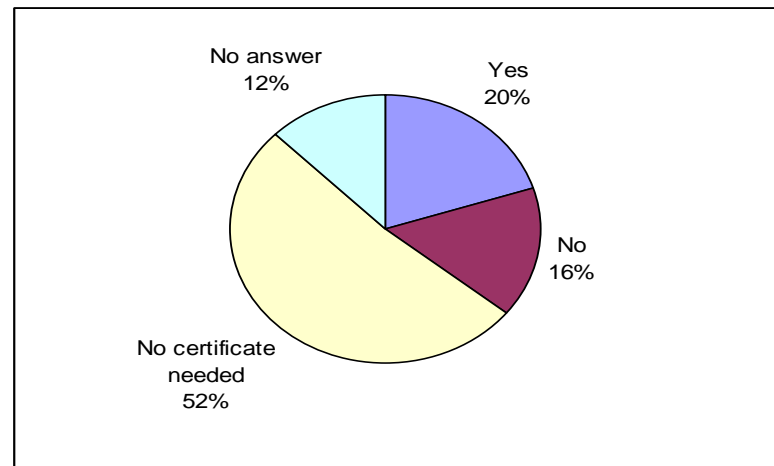
About one-sixth of businesses do not possess product standards certificates.

About 16% of formal/partially formal businesses surveyed do not have the required quality, health and safety standards certificates. In the Northern Region, about 23% of businesses do not have required certificates, higher than in other regions. About 26% of service sector businesses do not have the needed certificates (highest amongst sectors).

About 20% of businesses do possess these certificates, in particular larger sized firms which have more than 10 workers (40% of such businesses), and those that operate at a level higher than the region (33%).

Over 50% of businesses state that no certificates are required for their product or service line, and more so at the Chiefdom level (54%) and in the Eastern Region (70%).

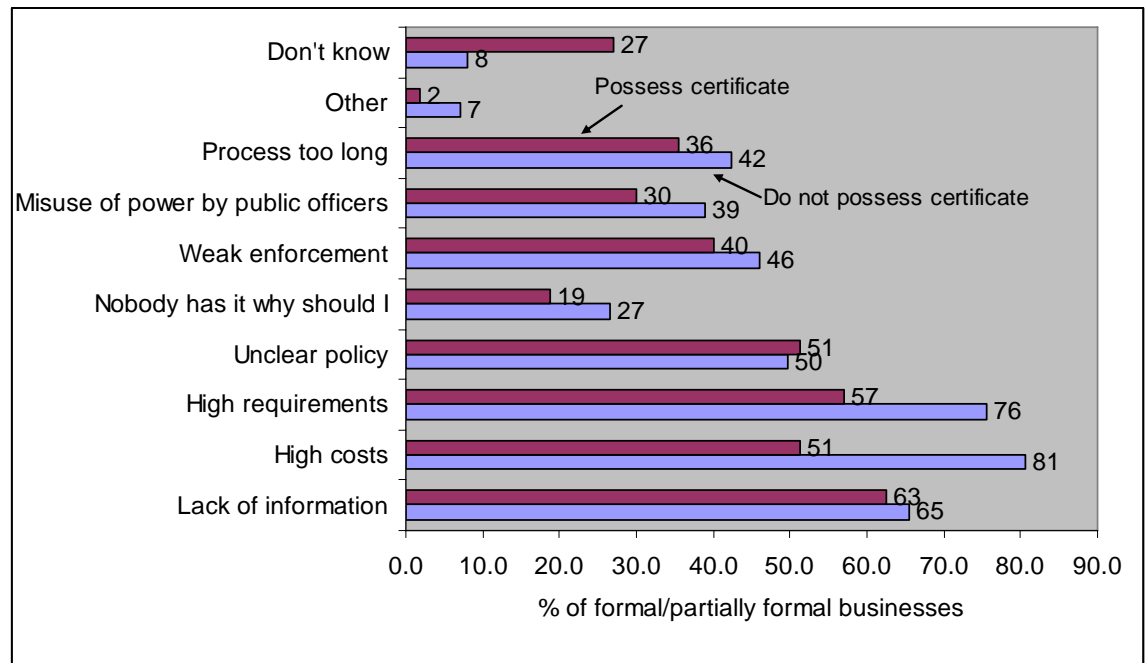
**Figure 7. Possession of required product standard certificate
(% of formal/partially formal businesses)**



Product standards certificates are not obtained mainly due to high costs and requirements, lack of information, and unclear policy. The high cost, both financial and time, and requirements to get a certificate are considered by almost 70% of businesses as reasons behind this type of informality – this view is held by respondents in relation to both their own business and that of competitors. Relative to other regions, the Western Area is more affected by these factors. Other reasons stated by many businesses are lack of information about the procedures to obtain certificates (65% of businesses) and unclear certificate policy in the sector (50%). Lack of information is cited by more businesses in the Southern and Western regions than others. Many more female respondents (36%)

than males (20%) do not get product standard certificates because others in their sector also do not.

Figure 8. Key reasons for not obtaining product standards certificates



At the sectoral level, more businesses in the trade sector and manufacturing sectors (about 70%) relative to other sectors regard lack of information as the reason for product standard informality. More businesses in the construction sector (almost 90%) consider high costs and requirements as the key factor.

Table 21. Reasons for not obtaining product standards certificates by sector

Reasons not to get certificate		Total	Sector					No answer
			Manufacturing	Trade	Services	Agriculture	Construction	
Lack of information	%	64.2	66.7	70.5	57.8	33.3	62.5	63.6
High costs	%	67.9	75.0	75.2	48.9	50.0	87.5	63.6
High requirements	%	67.5	62.5	73.6	62.2	55.6	87.5	50.0
Unclear policy	%	50.4	66.7	52.7	44.4	27.8	37.5	54.5
Nobody has it why should I	%	23.2	20.8	25.6	11.1	11.1	0.0	54.5
Weak enforcement	%	43.5	62.5	42.6	37.8	27.8	50.0	50.0
Misuse of power by public officers	%	35.0	33.3	37.2	20.0	16.7	37.5	68.2
Process too long	%	39.4	25.0	38.0	46.7	50.0	37.5	40.9
Other	%	4.9	8.3	7.8	0.0	0.0	0.0	0.0
Don't know	%	16.3	4.2	10.9	28.9	44.4	0.0	18.2
Total	Responses	1,014	102	560	161	57	32	102
	N	246	24	129	45	18	8	22

Base: Formal or partially formal businesses. Note: This is a multiple option answer - sum of percentages may exceed 100

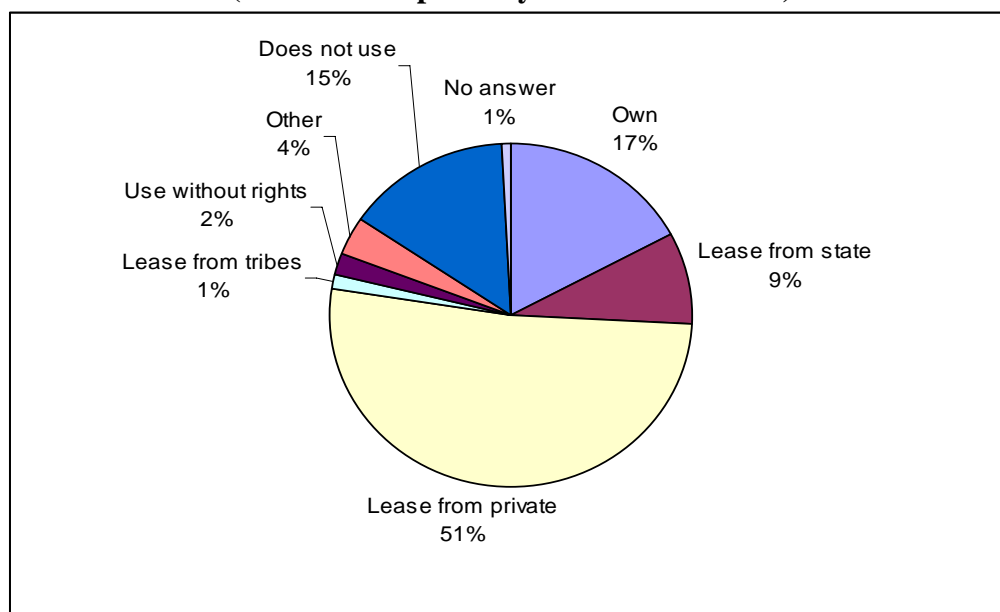
Land Informality

The survey reveals that the majority of businesses lease private land for their business activity. Of the businesses that use land in their everyday operations, over 50% lease private land. More smaller-sized businesses lease private land (55% of businesses with 3 or less workers). This is the also the case with relatively more businesses in the Western Area and Eastern region (63 and 70% respectively). More than half of businesses in the services sector lease private land, more than in other sectors.

Less than 20% of businesses own the land they operate on (see Figure 8). More larger-sized businesses own land than smaller ones. Relative to other regions, more businesses in the Southern Region (35%) operate on owned land. Such businesses are also relatively more in construction (46%) compared to other sectors.

Only 2% of businesses use land without rights. These include about 4% of the businesses with more than 10 workers. Such businesses are also relatively more concentrated in the Northern Region, where almost 40% operate without rights.

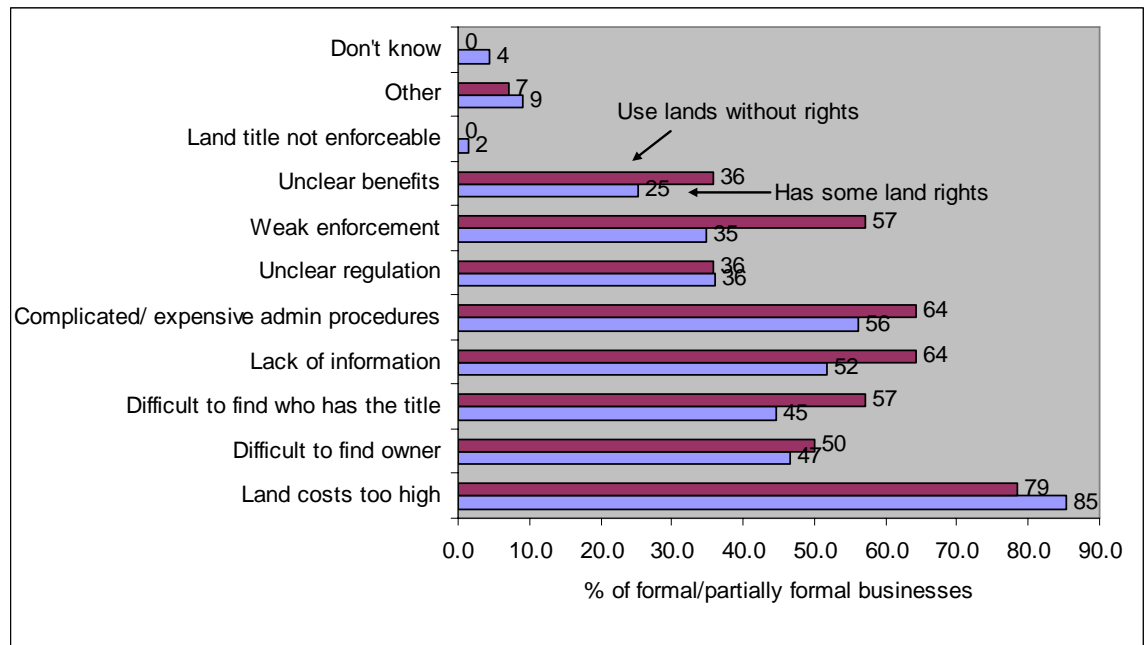
**Figure 9. Ownership rights on land used in business activity
(% of formal/partially formal businesses)**



Businesses operate on land without rights because of land costs, administrative barriers and lack of information. As much as 85% of all formal/partially formal

businesses – both those that have some land rights and those that use land without rights – believe that the reason businesses operate on informal land is that land costs are too high. A majority of businesses surveyed that use land without rights (64% of this group) also cite other reasons for informality: complicated and expensive administrative barriers related to land purchase/lease, as well as lack of information. Another 57% attribute this to difficulty in finding who has the official land title, and weak enforcement for using land without rights.

Figure 10. Reasons to not acquire legal land



More businesses with less than 10 workers consider the above reasons as leading to informality. In addition, more businesses in the Western Area and Southern Region believe that high land costs are a key factor than in other regions. Difficulty in finding land title is significant for more businesses in the Western Area.

Table 22. Reasons to not acquire legal land by business size

			Size of the company				
			Total	3 and less	4 - 10	More than 10	No answer
Reasons not to formalize land	Land costs too high	%	85.1	87.7	82.4	72.1	100.0
	Difficult to find owner	%	46.8	45.6	51.8	34.9	66.7
	Difficult to find who has the title	%	44.9	42.4	52.4	37.2	50.0
	Lack of information	%	52.0	51.2	57.1	37.2	66.7
	Complicated/ expensive admin procedures	%	56.4	55.5	59.4	46.5	100.0
	Unclear regulation	%	36.1	37.0	35.3	30.2	50.0
	Weak enforcement	%	35.3	34.9	36.5	32.6	50.0
	Unclear benefits	%	25.5	27.3	20.6	23.3	66.7
	Land title not enforceable	%	1.5	1.6	1.2	2.3	0.0
	Other	%	9.0	10.7	5.3	7.0	16.7
	Don't know	%	4.2	2.9	3.5	18.6	0.0
	Total	Responses	2,350	1,480	689	147	34
		N	592	373	170	43	6

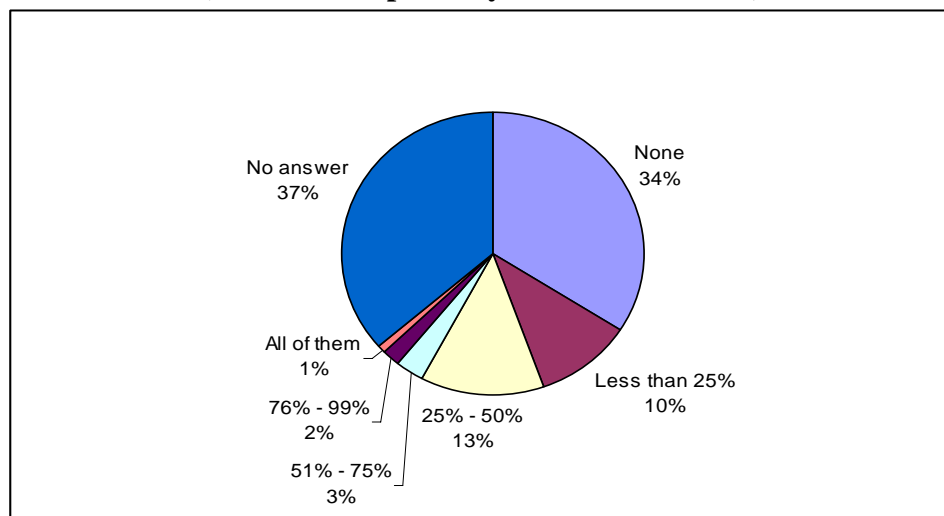
Base: Formal or partially formal businesses. Note: This is a multiple option answer - sum of percentages may exceed 100

Labor Informality

Over half the businesses surveyed are believed to report less than half of their workers. As much as 35% of formal/partially formal businesses think that other businesses in their area of operation do not report any of their workers to the authorities. Relatively more businesses in the Southern region (63%) are believed to not report any workers compared to other regions. Such businesses are also more concentrated in the agricultural and construction sector.

Another 25% believe that businesses report between 25-50% of their workers. Only 5% are thought report between 50-100% of workers.

Figure 11. Percentage of workers reported to authorities (% of formal/partially formal businesses)



The reasons behind not reporting all employees include high income tax, hiring and firing regulations, and high social security contributions. The majority of

formal/partially formal respondents (80%) consider one of the reasons for other businesses not reporting all workers to authorities is high income tax, as well as health, unemployment and retirement contributions (over 50% of businesses). These factors are significant for more respondents in the Western Area than other regions – where all respondents consider income tax is a factor, and for about 75% social security contributions are an important reason.

Complicated and expensive hiring and firing regulations are also cited as a motivation for labor informality (56% of businesses).

Table 23. Key reasons for not reporting workers to authorities

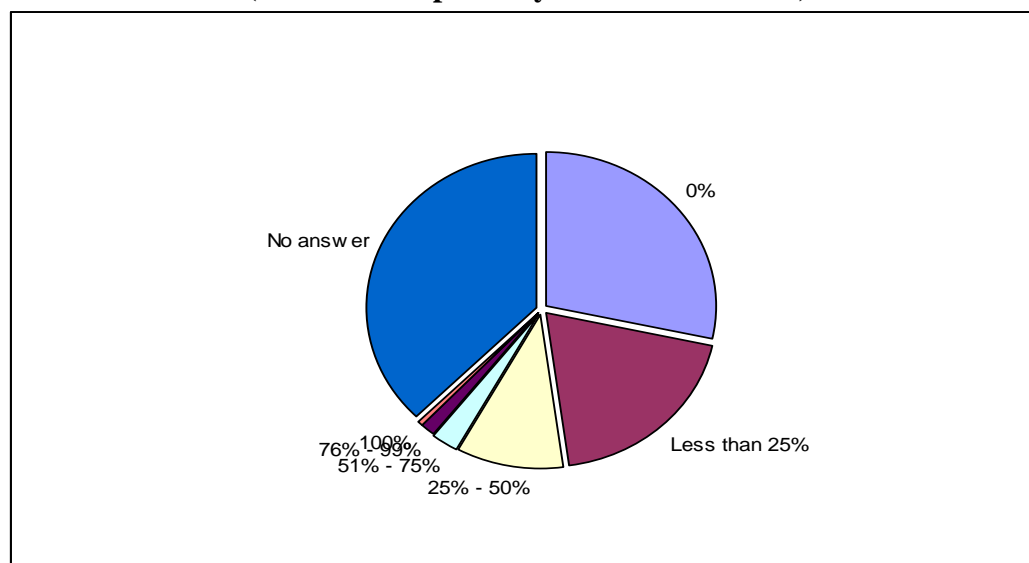
Reasons for not reporting employees		Percentage of workers reported to authorities							
		Total	None	Less than 25%	25% - 50%	51% - 75%	76% - 99%	All of them	No answer
High income tax	%	79.4	79.2	95.9	93.5	90.5	66.7	80.0	69.5
High health, unemployment and retirement contributions	%	52.9	46.7	60.3	66.7	57.1	46.7	60.0	51.6
Complicated/ expensive hiring/ firing regulation	%	55.8	55.0	67.1	61.3	57.1	33.3	60.0	52.3
Unclear labour regulation	%	44.8	45.8	50.7	47.3	61.9	40.0	40.0	40.2
Weak enforcement	%	48.6	45.8	61.6	63.4	38.1	46.7	60.0	43.0
Complicated procedure for under aged	%	28.7	30.0	41.1	28.0	38.1	20.0	20.0	24.2
Other	%	6.1	8.8	13.7	2.2	0.0	0.0	0.0	3.9
Don't know	%	13.7	10.4	4.1	4.3	4.8	20.0	20.0	23.0
Total	Responses	2,320	772	288	341	73	41	17	788
	N	703	240	73	93	21	15	5	256

Base: Formal or partially formal businesses. Note: This is a multiple option answer - sum of percentages may exceed 100

Most of the salaries of reported employees are under-reported for tax purposes.

About 60% of formal/partially formal businesses believe that other businesses in their area of operation report less than 50% of the salaries of their employees for taxes and contributions. Of the 30% that report none of their workers salaries, relatively more are concentrated in the Southern Region (60% of businesses in that region), and operate at the Chiefdom level. Of the businesses that report between 25-75% of worker’s salaries, higher proportions are in businesses with more than 10 workers. Also, of businesses that declare less than 25% of salaries, relatively more are in businesses (30%) that operate at a level higher than the region compared to other levels of operation.

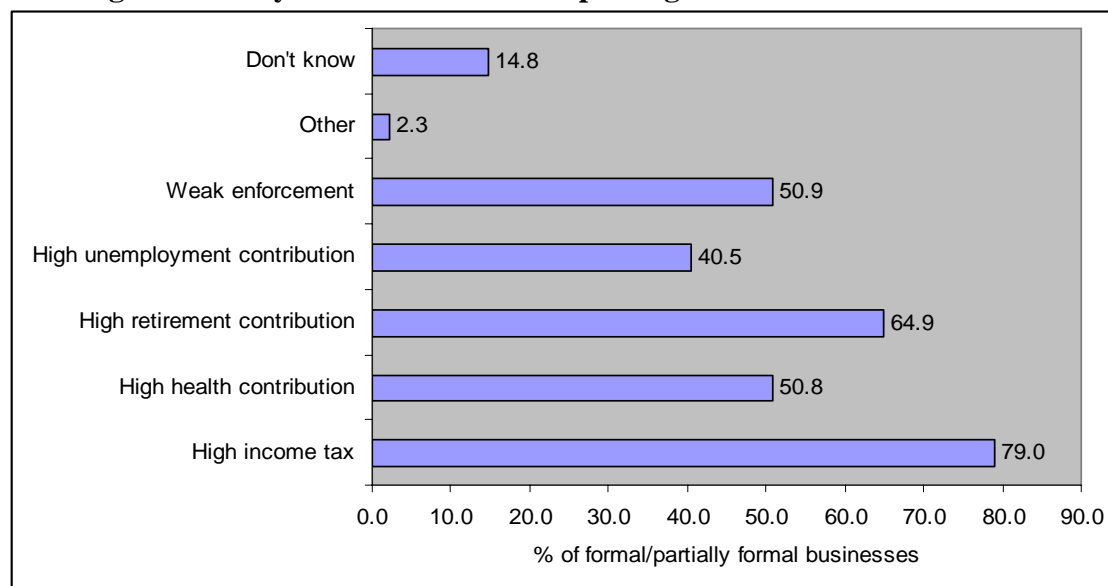
Figure 12. Percentage of workers reported to authorities (% of formal/partially formal businesses)



The most cited factors behind under-declaration of employees salaries are high income taxes and retirement contributions. Formal/partially formal businesses believe that businesses under-report workers salaries because of high income tax (80% of businesses hold this view), and high pension contributions (65%). In

addition, about half of businesses think that high health contributions as well as weak enforcement against unreported employees are other common reasons.

Figure 13. Key reasons for under-reporting salaries to authorities



All the options for possible reasons figure more prominently amongst the 4-10 worker sized businesses (see Table 24). More businesses in the Southern regions consider income tax as a factor (about 95%) compared to other regions. Weak enforcement is relatively more prominent in the Northern region. Sectoral differences also arise, and high income tax is a factor for more businesses in the manufacturing and construction sectors (85% of businesses in both sectors). Also, weak enforcement is a reason for more businesses in the manufacturing sector.

Table 24. Key reasons for under-reporting salaries to authorities by size of business

			Size of the company				
			Total	3 and less	4 - 10	More than 10	No answer
Reasons for not reporting salaries	High income tax	%	79.0	78.8	83.2	68.8	40.0
	High health contribution	%	50.8	47.8	60.0	45.8	20.0
	High retirement contribution	%	64.9	63.5	72.6	52.1	20.0
	High unemployment contribution	%	40.5	38.9	47.4	31.3	20.0
	Weak enforcement	%	50.9	50.7	52.1	50.0	40.0
	Other	%	2.3	2.8	1.1	2.1	0.0
	Don't know	%	14.8	15.7	9.5	22.9	60.0
Total	Responses	2,126	1,366	619	131	10	
	N	701	458	190	48	5	

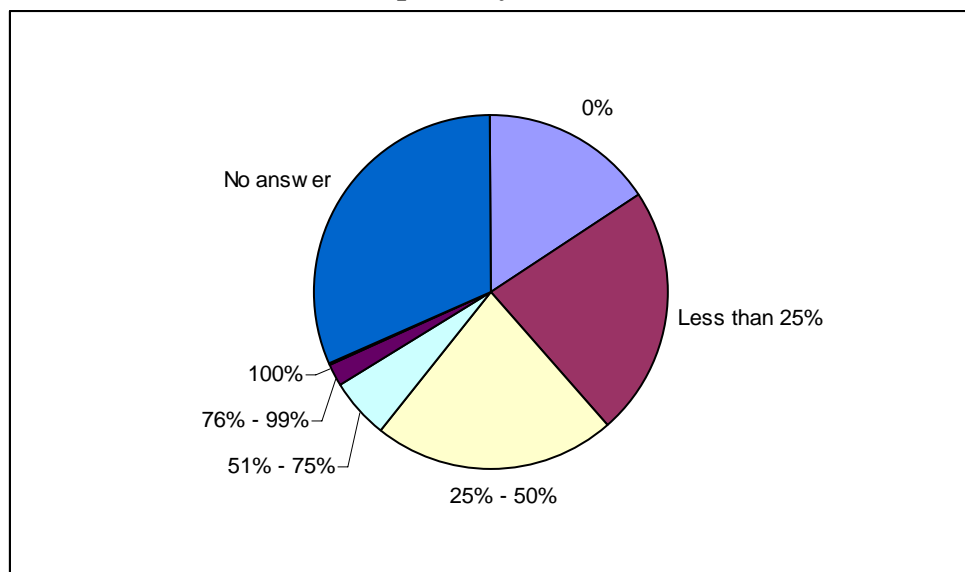
Base: Formal or partially formal businesses. Note: This is a multiple option answer - sum of percentages may exceed 100

Tax Informality

The majority of businesses report less than half of turnover for tax purposes.

The survey finds that businesses report that 60% of formal/partially formal businesses in their area of business report less than 50% of their turnover for tax. According to Doing Business, total tax payments (as % of gross profit) are substantially higher than the average for the region (see Box 7).

**Figure 14. Percentage of turnover reported for tax purposes
(% of formal/partially formal businesses)**



About 16% of businesses are believed to report 0% business turnover. These are primarily larger firms, those operating at the Chiefdom and District level, and in the Southern regions (40% of businesses). Between 25-30% of businesses in the agriculture, manufacturing and construction sector are believed the report no turnover. However, only less than 3% of all businesses are thought to report more than 75% of turnover.

**Table 25. Percentage of turnover reported for tax purposes by size of business
(% of businesses)**

		Size of the company				
		Total	3 and less	4 - 10	More than 10	No answer
Percentage of turnover reported to authorities	0%	15.8	14.2	17.9	25.0	0.0
	Less than 25%	22.9	25.1	20.0	12.5	33.3
	25% - 50%	21.9	22.2	21.1	20.8	33.3
	51% - 75%	5.4	4.6	5.3	14.6	0.0
	76% - 99%	2.0	1.7	2.1	2.1	16.7
	100%	0.4	0.4	0.5	0.0	0.0
	No answer	31.6	31.8	33.2	25.0	16.7
	Total	703	459	190	48	6
	Mean	34.4	32.4	36.5	44.0	40.0
	N	217	140	59	15	3

Base: Formal or partially formal businesses

**Table 26. Percentage of turnover reported for tax purposes by sector
(% of businesses)**

		Sector						
		Total	Manufacturing	Trade	Services	Agriculture	Construction	No answer
Percentage of turnover reported to authorities	0%	15.8	24.7	14.9	13.6	28.6	23.1	2.3
	Less than 25%	22.9	23.3	24.4	27.2	5.7	15.4	13.6
	25% - 50%	21.9	27.4	22.1	21.4	22.9	23.1	11.4
	51% - 75%	5.4	1.4	6.0	2.9	8.6	23.1	4.5
	76% - 99%	2.0	1.4	1.8	2.9	0.0	7.7	2.3
	100%	0.4	0.0	0.2	1.0	0.0	0.0	2.3
	No answer	31.6	21.9	30.6	31.1	34.3	7.7	63.6
	Total	703	73	435	103	35	13	44
	Mean	34.4	31.7	33.3	36.6	40.8	50.0	35.0
	N	217	15	144	34	6	6	12

Base: Formal or partially formal businesses

Box 7. Paying Taxes in Sierra Leone

According to the Doing Business, entrepreneurs (in a medium sized firm) in Sierra Leone had to make **20** payments, spend **399** hours, and pay **163.9%** of gross profit in taxes during 2005.

	Sierra Leone	Region	OECD
Payments (number)	20	41.4	16.3
Time (hours)	399	394.0	197.2
Total tax payable (% gross profit)	163.9	58.1	45.4

Source: Doing Business 2005, World Bank.

Reinvestments and loans

Reinvested Sales

Completely informal businesses reinvested less of their past sales compared to formal/partially businesses. Over half of all businesses reinvested between 20-60% of their sales. About 10% of all businesses did not reinvest any of their sales in the last year, and relatively more of these were completely informal businesses and businesses operated by females.

Table 27. Percentage of sales reinvested in business (% of businesses)

			Formality status		
			Total	Formal or partially formal	Completely informal
Level of reinvestment	0%	%	9.5	7.7	11.4
	1% - 10%	%	12.8	9.4	16.5
	11% - 20%	%	17.8	15.4	20.3
	21% - 40%	%	26.4	29.7	22.9
	41% - 60%	%	23.2	27.0	19.1
	More than 60%	%	8.1	7.8	8.3
	No answer	%	2.2	3.0	1.4
	Total	N	1,362	703	659
	Mean		32	34	29
	N		1,332	682	650

Loans Applications

Most businesses have not applied for a loan in the past two years. About 80% of businesses have not applied for a loan for business purposes over the last two years. This was the case for relatively more businesses that operate at the Chiefdom level. Also, more businesses in the services and agricultural sectors did not apply for loan, whereas more in the construction sector did (see Table 28).

Table 28. Businesses that applied for a loan by sector (%)

			Sector						
			Total	Manufacturing	Trade	Services	Agriculture	Construction	No answer
Applied for a loan	Yes	%	20.6	25.6	23.2	12.4	12.8	45.0	17.9
	No	%	79.4	74.4	76.8	87.6	87.2	55.0	82.1
	Total	N	1,362	121	790	242	133	20	56

Base: All respondents

About one-third of loan applications were rejected, especially for completely informal businesses. Almost 45% of completely informal businesses had loan applications rejected over the past two years, compared to less than 30% of formal/partially formal businesses. About 63% of businesses in the Western Area had loan applications rejected compared to over 25% in the Eastern Region. In addition, relatively more businesses in the agriculture and construction sectors

had loan applications rejected compared to other sectors (above 40%). Interestingly, more female respondents (54%) had approved loan applications compared to males (42%), while about one-third of both had application rejected (the balance are mainly applications ‘in process’).

Table 29. Result of loan application (% of businesses)

			Formality status		
			Total	partially formal	informal
Result of application	Approved	%	45.7	47.8	42.9
	Rejected	%	34.6	28.0	43.7
	In process	%	16.8	20.5	11.8
	No answer	%	2.9	3.7	1.7
	Total	N	280	161	119

Base: All respondents

More than half of businesses have not applied for a loan because of low chances of getting one. Over 50% of businesses have not made a loan application over the past two years since they ‘know they cannot get one’. This is particularly the case for smaller sized businesses, those operating in the Southern Region, and in the agricultural sector.

Table 30. Reason for not applying for a loan

			Formality status		
			Total	partially formal	informal
Reason for not applying	I don't need	%	13.6	16.8	10.4
	I know I can't	%	52.6	51.7	53.5
	Other	%	24.1	23.8	24.4
	No answer	%	9.7	7.7	11.7
	Total	N	1,082	542	540

Base: All respondents

General Obstacles for Business Operation

The other problems in the investment climate identified by most businesses include access and cost of financing. Access to financing, followed by cost of financing is considered by respondents as a key obstacle for business operation and growth (87% and 78% of businesses). In addition, almost 75% of businesses regard transportation infrastructure and availability of electricity as problems. Over 60% of community leaders consider the lack of availability of information from the government as an impediment.

**Table 31. Obstacles for business operation and growth
(% of respondents claiming an issue is an obstacle)**

	Formality status			
	Total %	Formal or partially formal %	Completely informal %	Community leaders %
Telecommunication - cost	62.6	66.3	57.0	72.2
Telecommunications availability	60.2	58.5	59.9	71.6
Electricity cost	67.4	71.4	62.2	72.8
Electricity availability	73.1	73.8	71.2	79.5
Water availability	50.7	58.8	39.3	0.0
Transportation infrastructure	74.6	73.9	73.6	83.5
Skills and education of available workers	38.9	42.9	34.8	39.3
Access to financing	86.7	86.1	87.7	84.3
Cost of financing	78.4	81.2	75.3	79.1
Regulatory policy uncertainty	36.3	40.7	33.0	29.4
Macroeconomic Instability	58.6	59.1	58.2	57.9
Corruption	58.7	56.8	57.7	73.6
Crime, theft and disorder	64.8	65.9	64.9	57.5
Access to land	56.1	59.6	56.0	35.1
Access to premises	52.3	55.0	52.8	33.9
Regulatory burden in general	26.5	26.5	0.0	0.0
Availability of information from govt	62.8	0.0	0.0	62.8

Base: All respondents including Community Leaders