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CONTACTS

Phone: **+998 50 737 87 88**

Website: <https://ist-journal.uz>

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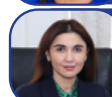
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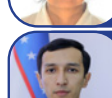
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DIFFERENTIATED APPROACHES TO INCENTIVIZING THE TRANSITION OF SMALL BUSINESSES TO THE FORMAL ECONOMY

Yunusov Marat Erkinovich

Independent Researcher at Kokand University

Annotatsiya. Maqolada kichik biznes subyektlarini rasmiy iqtisodiyotga jalb etishda yagona rag'batlantirish paketining cheklovlari hamda tadbirkorlik profillariga mos differensial siyosat yuritish zarurati tadqiq etiladi. Ro'yxatdan o'tmagan mikrofaoliyat, hujjat aylanishi to'liq shakllanmagan ro'yxatdan o'tgan biznes, o'sishga moyil kichik korxona va huquqiy talablarga muvofiqlik xavfi qayd etilgan subyektlar uchun rasmiylashuv to'siqlari farqlanadi. Xalqaro tajriba va O'zbekistonning amaldagi institutsional sharoitlarini qiyosiy tahlil qilish asosida to'rtta profil, ularga mos manzilli rag'batlantirish paketlari va o'n ikki oylik kuzatuv algoritmi ishlab chiqilgan. Taklif etilgan yondashuvda dastur samaradorligi bir martalik ro'yxatdan o'tish bilan emas, balki rasmiy faoliyatning davomiyligi, hujjatlashtirilgan aylanma, mehnat munosabatlarining rasmiyligi va har bir qo'shimcha barqaror faoliyat yurituvchi subyektga to'g'ri keladigan davlat xarajatlari orqali baholanadi.

Kalit so'zlar: kichik biznes, rasmiy iqtisodiyot, differensial rag'batlantirish, norasmiy faoliyat, tadbirkorlik profili, manzilli qo'llab-quvvatlash, muvofiqlik xarajatlari, moliyaviy inklyuziya, xulq-atvor, monitoring.

Аннотация. В статье исследуются ограничения единого пакета стимулирования при вовлечении субъектов малого бизнеса в формальную экономику и необходимость проведения дифференцированной политики с учётом предпринимательских профилей. Разграничиваются барьеры формализации для незарегистрированной микропредпринимательской деятельности, зарегистрированного бизнеса с недостаточно налаженным документооборотом, малых предприятий с потенциалом роста и субъектов с выявленными рисками несоблюдения правовых требований. На основе сравнительного анализа международного опыта и действующих институциональных условий Узбекистана разработаны четыре профиля, соответствующие им адресные пакеты стимулирования и алгоритм двенадцатимесячного наблюдения. В предлагаемом подходе эффективность программы оценивается не по факту разовой регистрации, а по продолжительности формальной деятельности, документально подтверждённому обороту, официальному оформлению трудовых отношений и государственным затратам на каждый дополнительный устойчиво функционирующий субъект.

Ключевые слова: малый бизнес, формальная экономика, дифференцированное стимулирование, неформальная деятельность, предпринимательский профиль, адресная поддержка, издержки соблюдения требований, финансовая инклюзия, поведение, мониторинг.

Abstract. The article examines the limitations of a uniform incentive package for integrating small businesses into the formal economy and the need for differentiated policies tailored to business profiles. It distinguishes formalization barriers faced by unregistered microbusinesses, registered businesses with insufficiently established recordkeeping practices, small enterprises with growth potential, and entities with identified legal compliance risks. A comparative analysis of international experience and Uzbekistan's current institutional conditions serves as the basis for developing four profiles, corresponding targeted incentive packages, and a twelve-month monitoring algorithm. Under the proposed approach, program effectiveness is assessed through the continuity of formal operations, documented turnover, formalized employment relationships, and public expenditure per additional business that remains formally operational, rather than through one-time registration.

Keywords: small business, formal economy, differentiated incentives, informal activity, business profile, targeted support, compliance costs, financial inclusion, behavior, monitoring.

INTRODUCTION

The transition of small businesses from the informal sector to the formal economy expands the tax base, promotes fair competition, and safeguards labor rights, while providing entrepreneurs with access to contractual arrangements, finance, stable customers, and legal protection. However, the benefits of formal status vary across businesses: bookkeeping requirements and time costs may constitute significant barriers for some microbusinesses, whereas access to large buyers and bank credit may be the primary incentive for growing enterprises. Consequently, general administrative simplification does not have the same effect on entrepreneurs operating under different economic conditions [1; 2].

In its December 2025 publication on Uzbekistan, the World Bank reported that micro, small, and medium enterprises accounted for approximately 55 percent of gross domestic product and that more than one-third of these businesses did

not have a bank account [3]. These figures indicate gaps in financial inclusion; however, the absence of a bank account should not be equated with business informality. This distinction has methodological significance for accurately identifying the target groups of incentive programs.

LITERATURE REVIEW

The International Labour Organization's Recommendation No. 204 emphasizes that workers and economic units in the informal economy differ in their circumstances, needs, and capacities, requiring appropriately tailored measures. The Recommendation identifies reduced registration costs, simplified taxation, and expanded access to financial services, public procurement, and social protection as interconnected instruments [1]. Thus, depending on the barriers faced by a business, incentives for formalization may take the form of administrative measures, financial support, or market institutions.

Using data on small firms in Bolivia, D. McKenzie and Y. S. Sakho found that the effect of tax registration on profits varied according to firm size and circumstances [6]. Designing a general program based on average indicators may obscure such disparities between business segments. Therefore, the potential economic benefits of a particular support instrument should be assessed before that instrument is selected.

In an experiment in Benin, N. Benhassine, D. McKenzie, V. Pouliquen, and M. Santini demonstrated that providing information alone had a limited effect on business registration, whereas combining advisory services with additional support measures increased formalization. At the same time, they noted that a broad program could entail high costs and that registration alone did not automatically increase firm sales or profits [7]. These findings suggest two relevant criteria for designing a differentiated approach: which businesses respond to a particular incentive and how much the resulting outcome costs the government.

M. Bruhn found that simplifying business registration procedures in Mexico affected the number of new formal firms but did not automatically lead all previously informal businesses to formalize [8]. Meanwhile, the World Bank study edited by F. Ohnsorge and S. Yu examined the reduction of informality in conjunction with productivity, institutions, and financial development, rather than solely in terms of tax enforcement [2]. International empirical evidence thus supports the distinction between the objective of formalization and its economic effects.

The distinctive contribution of this study lies in developing a logical sequence for allocating support—"dominant barrier — appropriate instrument — observable outcome"—rather than reiterating a general classification of formalization instruments. This sequence links individual business profiles to the practical outcomes of public policy.

RESEARCH METHODOLOGY

The study employed institutional comparison, content analysis of scholarly sources, barrier-based profiling, cause-and-effect mapping, and program evaluation methods. The unit of analysis was the small business entity, with legal status, the extent of turnover documentation, organizational capabilities, and opportunities in formal markets serving as distinguishing characteristics. Since firm-level microdata were not used at this stage, the proposed segments represent a preliminary management typology based on theoretical and practical criteria, rather than the results of statistical clustering.

Within the differentiated approach, the initial diagnostic question is: "Why does the business remain informal, or why does it fail to fully disclose its transactions despite having formal status?" This question is examined across four dimensions: legal status, bookkeeping skills, financial profitability, and document compliance. A business may face several barriers simultaneously; therefore, the selection of the priority instrument is intended to draw on the entrepreneur's consent, the findings of advisory consultations, and the verification of lawfully obtained data.

ANALYSIS AND RESULTS

Systematizing the sources made it possible to identify four practical formalization profiles. In the first profile, the costs of entering the formal legal framework and obtaining information may predominate. In the second, the business is registered but encounters difficulties in routine operations, such as issuing fiscal receipts and invoices or formalizing employment relationships. The third group has the potential to expand its participation in formal markets but faces high financing and customer acquisition costs. The fourth profile comprises businesses for which lawful inspections have identified compliance discrepancies. This classification is used to clarify the objectives of policy instruments, rather than to categorize businesses as "good" or "bad" (Table 1).

Table 1
Target Profiles of Small Businesses by Barriers to Transitioning to the Formal Economy¹

Profile	Defining condition	Main barrier	Initial management priority
A. Entry barrier	Business activity exists, but registration has not been completed	Information, time, and procedural costs	Simplifying entry into the formal legal framework and providing advisory support
B. Bookkeeping barrier	The business is registered, but formal operating practices are not fully established	Bookkeeping, digital tools, and staff skills	Practical training and technical assistance
C. Growth barrier	The business is ready to formalize, but market opportunities are limited	Access to credit, guarantees, contracts, and a customer base	Conditional access to market opportunities and financial services
D. Compliance risk	Non-compliance has been documented by a competent authority	Risks associated with disclosure and meeting legal requirements	A corrective action plan and proportionate oversight

The methodological advantage of Table 1 lies in identifying each segment through the principal mechanism hindering formalization, rather than solely by business size or type of activity. For example, two firms with the same turnover may face different barriers: one may lack the skills needed to use a payment terminal, while the other may lack access to buyers operating under formal contracts. Preferential credit may fail to address the first firm's problem, whereas a general information seminar may yield little benefit for the second.

However, data quality is crucial when assigning profiles. Low reported sales do not constitute proof of deliberate turnover concealment; they may reflect seasonality, the geographical characteristics of the market, or the initial development phase of a newly established business. Therefore, Profile D should be assigned only on the basis of legal non-compliance established through the prescribed procedures or verified data substantiating such non-compliance. The segmentation algorithm should not be used as a tool for making automated decisions to impose penalties.

On this basis, a decision tree for selecting targeted support was proposed. First, the legal status of the business activity and the main economic barrier are identified; next, a minimal but sufficient package of instruments is developed to match the business profile. An essential requirement at the initial stage is to specify in advance the outcome to be monitored, alongside the support to be provided (Figure 1.).

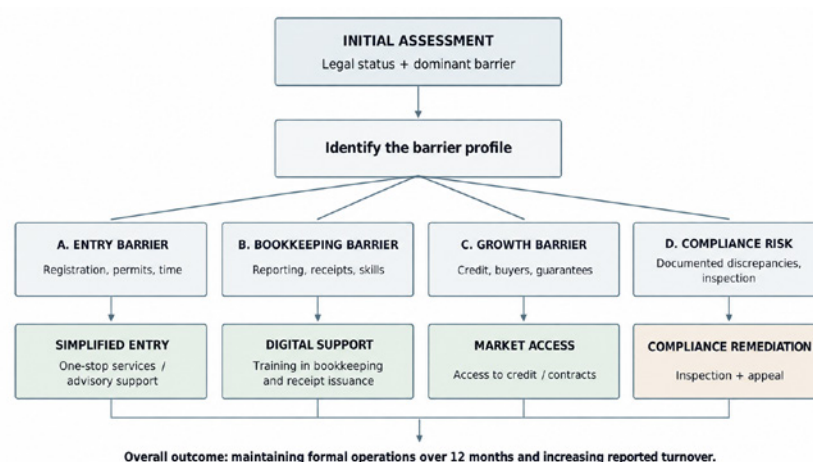


Figure 1. Algorithm for Selecting a Differentiated Incentive Package for Small Businesses²

¹ Developed by the author.

² Developed by the author.

Figure 1 shows how support instruments are differentiated by barrier type following an initial assessment. For entry barriers, one-stop services and advisory assistance are essential; for bookkeeping barriers, the priority is practical training in the use of digital services; and for growth barriers, the emphasis is on access to financing and new markets through formal contracts. Where compliance discrepancies exist, a lawful corrective action plan should be combined with guidance and any necessary inspections. The ultimate criterion for all four pathways is the sustained continuation of formal business operations.

If incentives are limited to easing the initial process, public expenditure will produce only a one-time registration outcome. Therefore, each profile requires a sequence of support measures whose objectives evolve over time. For example, once the entry barrier has been reduced, the focus shifts to maintaining accurate records and increasing the share of ongoing contractual relationships. Government support should progressively adapt to these needs (Table 2).

Table 2
Targeted Incentive Packages by Small Business Profile and Expected Immediate Outcomes³

Profile	Initial incentive package	Follow-up targeted service	Observable immediate outcome
A — Entry	One-stop consultation and hands-on assistance with registration	Assistance with preparing the first report and entering into a contract	Formal status and the first formal transaction
B — Bookkeeping	Practical bookkeeping training and digital services	Periodic document reviews and advice on formalizing employment relationships	Continuity of officially recorded revenue and documentation
C — Growth	Financial readiness assessment and referral to banking services	Access to buyer networks, guidance on procurement procedures, and contractual advice	A formal order and opportunities for transparent trading
D — Compliance	Legal guidance and a corrective action plan addressing verified deficiencies	Lawful inspection procedures, the right to submit objections, and subsequent review	Resolution of identified non-compliance

The services listed in Table 2 do not constitute an automatic promise of existing benefits; they have been designed as proposed pilot packages. In particular, assistance with accessing credit does not guarantee loan approval: banks retain their independent risk assessment, and applicable statutory procedures remain in place. Similarly, providing additional advisory support during oversight procedures does not imply the postponement of legal obligations or exemption from oversight.

The effectiveness of differentiated incentives is likely to depend more on their alignment with the specific barriers faced by businesses than on the intensity of support alone. For Profile A, brief practical advice provided during the first few weeks may be effective. For Profile C, longer-term assistance with business planning and securing contracts may be required to increase the benefits of participation in formal markets. For Profile D, the principal measure is a clear procedure for restoring legal compliance rather than a standalone economic incentive. Such differentiation reduces the risk of allocating limited public resources to uniform interventions.

To monitor formalization dynamically, three stages are recommended within a twelve-month pilot period: reducing entry barriers during months 0–3; adapting to bookkeeping, contractual, and operational requirements during months 4–6; and strengthening the continuity of formal operations during months 7–12. These periods represent a monitoring design developed for testing within the study, rather than mandatory legal requirements.

When evaluating the study's results, the number of registered businesses is an initial indicator, but not the final outcome. Assessing sustainability requires determining the proportion of program participants still operating formally after twelve

³ Developed by the author.

months. If registration produces a large number of inactive firms, initial numerical success does not translate into long-term economic benefits. Comparing outcomes with those of a similar group that received no incentives helps distinguish the program's effects from seasonality and overall market growth.

The denominator of the "cost per sustainably operating business" indicator in Table 3 is the number of additional sustainably operating businesses attributable to the program relative to the counterfactual without the program, rather than the total number of registered businesses. If this additional effect is zero or negative, the indicator must not be calculated in a way that artificially presents a positive result; the failure to achieve cost-effectiveness should be reported separately. Likewise, changes in prices and general market conditions should be taken into account when interpreting turnover growth (Table 3).

Table 3
Proposed Outcome and Cost Indicators for Evaluating a Differentiated Incentive Program⁴

Indicator	Calculation / measurement method	Monitoring period	Evaluation focus
Formalization rate	Number of participants who formalized / number of initially informal participants × 100	Months 3, 6, and 12	Initial transition outcome
12-month retention rate	Number of formalized businesses still operating formally at month 12 / total number of businesses that formalized × 100	Month 12	Sustainability of the outcome
Reported turnover dynamics	Change in documented turnover relative to the baseline	Quarterly	Extent of formal business transactions
Formal employment	Number and proportion of employees with registered employment contracts	Months 6 and 12	Transparency of employment relationships
Compliance costs	Periodic surveys of time spent and service costs incurred in reporting and registration	Months 0, 6, and 12	Reduction in costs borne by entrepreneurs
Net program effect	Outcome in the program group – outcome in the comparison group (adjusted estimate)	Months 6 and 12	Additional effect attributable to the program
Cost per additional sustainably operating formal business	Total program expenditure / number of additional sustainably operating formal businesses	Month 12	Cost-effectiveness of public expenditure

Changes in the composition of participating businesses should also be controlled for when evaluating a differentiated program. For example, entrepreneurs who voluntarily join the pilot may already be more inclined to formalize. In such cases, increased registration may reflect selection bias rather than the program's effect. Phased implementation, matched comparison groups, and predefined final outcome indicators help reduce this risk. Comparisons must ensure lawful data processing and the protection of personal data.

The results may also be interpreted across regions and sectors. In retail and personal services, training in cash register procedures may be an immediate priority, whereas small manufacturers operating on an order basis may place greater importance on adherence to contractual obligations, invoicing, and access to financial resources. However, these differences should not be established as rigid rules in advance; they should be verified through actual diagnostic assessments in each region and sector.

Organizing differentiated support also requires a clear separation of responsibilities between public authorities and advisory organizations. An advisor providing information and business support should not recommend a business for inspection merely because it has received advisory services. Decisions to initiate inspections should be made exclusively by the competent authority on appropriate procedural grounds. This arrangement is important for strengthening trust in voluntary program participation and limiting the risk of conflicts of interest.

⁴ Prepared by the author based on the research data.

CONCLUSIONS AND RECOMMENDATIONS

First, the study established that institutional barriers to the transition of small businesses to the formal economy are not uniform. Distinguishing between registration costs, recordkeeping skills, insufficient benefits from formal market participation, and legal compliance issues makes it possible to transform a general incentive program into a targeted mechanism.

Second, four target segments, designated A–D, were developed according to the dominant barrier profile, together with a separate sequence of services for each segment. This approach prioritizes registration assistance and advisory support for businesses starting operations, digital bookkeeping support for registered businesses facing operational difficulties, and market access services for firms with growth potential.

Third, the study proposed a framework for adapting targeted support across three stages: months 0–3, 4–6, and 7–12. The proposal is intended to support sustained formal operations rather than merely short-term registration and may be tested through a pilot program within the existing legal framework.

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