

MAR:  
2021

# New perspectives on informality: a focus on the South African context

PROMOTION AND DEVELOPMENT OF SMALL BUSINESS IN SOUTH  
AFRICA, COVID -19 AND BEYOND



## Acknowledgements

The Small Business Institute (SBI) gratefully acknowledges the financial support of mining company Exxaro in the preparation of this research and resulting suite of papers. The careful work in undertaking this research and preparation of the papers by SBP's (Small Business Project) research and policy expert contributors Ximena Gonzalez, Dr Myriam Velia, Chris Darroll and Jennifer Cohen is also gratefully acknowledged.



We would like to thank the many businesspeople who participated in this research and who generously contributed their time. Our special thanks to Linda Grimbeek, Chief Operating Officer of the Kruger Lowveld Chamber of Business and Tourism (KLCBT) and Hettienne Von Abo Moolman, SBI's Director of Sectoral Coordination (Bothaville). Your enthusiasm and leadership to help make change happen and bring value to your local towns is an inspiration to all.

The SBI welcomes feedback on this research and the resulting suite of papers, which can be submitted to Ms Leandre Swart at [leandre@smallbusinessinstitute.co.za](mailto:leandre@smallbusinessinstitute.co.za)

Research project undertaken for the Small Business Institute (SBI), funded by Exxaro – Conducted by research specialists SBP

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# Preface

Prior to Covid-19 micro, small and medium enterprises – we refer to all these businesses as SMEs for brevity – constituted by far the majority of businesses in South Africa. Over 98% of all employing firms in the country employed fewer than 250 people, including medium-sized businesses, and the majority of firms (66%) were, according to our research published in 2018, micro businesses with ten or fewer employees. While there is no reliable data to inform us of how many survived, we are certain that SMEs remain in the majority, as they are around the world, despite rising liquidations and distressing turnover numbers due to the impact of the Covid-19 pandemic and the lockdown measures to contain it.

And yet instead of seeing SMEs as the engine room of our economy despite all the lip service paid by government and big business to them, they are forever treated as an economic widget. Policy and regulations are made for big businesses with large compliance departments, years of much-documented hostility by government is directed at big business, sweeping all ‘business’ together in unhelpful generalisations; and though much ink has been spilled writing about an enabling environment, there has been insufficient understanding applied to what this should look like.

It is one year on since government introduced the lockdown measures to contain Covid-19. The Small Business Institute (SBI) with support from mining house Exxaro has undertaken research in a Covid-19 world to analyse the situational environment for SMEs in South Africa. Conducted by SME research specialists, SBP, we provide a deeper understanding of the key barriers affecting SMEs and propose a set of recommendations aimed at addressing these problems. Our suite of papers is built on a review of a vast array of decisive studies and an assessment of critical barriers affecting SME performance based on available evidence. South African SMEs face many structural barriers to their formation, growth and expansion. All businesses, especially SMEs were having a tough time of it before the appearance of the novel coronavirus pandemic. There will be no point to layering clever, forward-looking initiatives on top of a foundation that has impeded business growth for decades in South Africa.

While “the business of business is business” as Milton Friedman might say, the multiplier effects of business on a country’s development and prosperity for all its people are well documented. Business activity creates jobs, cultivates inter-firm linkages, enables innovation and technology transfer, builds human capital and physical infrastructure, generates tax revenues for governments, and, of course, offers a variety of products and services to consumers and other businesses. And it is in SMEs where the true spirit of enterprise is embodied. Under the right conditions, a vigorous and thriving SME community can enhance competition, entrepreneurship, job growth and spur economy-wide efficiency and innovation.

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Over the past year, an inordinate amount of energy and effort has been devoted to trying to formalise enterprises that are not caught up in the net. Any firm that sells a product or service contributes to our fiscus through the VAT tax they pay on inputs. All circulate money in the economy. One of the papers in our series has sifted through the rationale for formalisation and the pros and cons of the informal-formal continuum and where good policy to support *any* business along its journey to sustainability might focus. Another will clearly spell out what South Africa requires to truly enable businesses to start, run and grow, accommodating hiring along the way.

*In this paper* we examine the complex issue of informality. Many people in South Africa are running small informal businesses because they lack job opportunities. These firms, which differ widely, represent only one facet of the small business sector – we ask how their positive contributions to the broader economy be celebrated rather than penalised? Drawing on both local and international literature, we highlight the heterogeneity among small firms, suggest that policy makers should consider businesses along an informal-formal continuum rather than as a binary condition. We also discuss the focus on compliance and enforcement superseding ways to catalyse growth and employment. Importantly, we reiterate the call we make in our paper about the promise digitalisation for government to prioritise the required infrastructure for townships and rural areas to access the inclusiveness of this new world.

# Abbreviations

4IR	Fourth Industrial Revolution
AfDB	African Development Bank
CIPC	Companies and Intellectual Property Commission
DSBD	Department of Small Business Development
FMCG	Fast Moving Consumer Goods
GEM	Global Entrepreneurship Monitor
GIS	Geographic Information System
IEJ	Institute for Economic Justice
ILO	International Labour Organisation
IMF	International Monetary Fund
MICT	Mobile Information and Communications Technology
NDP	National Development Plan
NPC	National Planning Commission
NPO	Non-Profit Organisation
OECD	Organisation for Economic Co-operation and Development
QLFS	Quarterly Labour Force Survey
SALGA	South Africa Local Government Association
SARS	South African Revenue Services
SBI	Small Business Institute
SBP	Small Business Project
SEFA	Small Enterprise Finance Agency
SERI	Socio-Economic Rights Institute
SESE	Survey of Employers and the Self-Employed
SME	Small and Medium Enterprise
SMME	Small, Medium and Micro Enterprise
StatsSA	Statistics South Africa
UIF	Unemployment Insurance Fund
VAT	Value Added Tax
WIEGO	Women in Informal Employment: Globalising and Organising

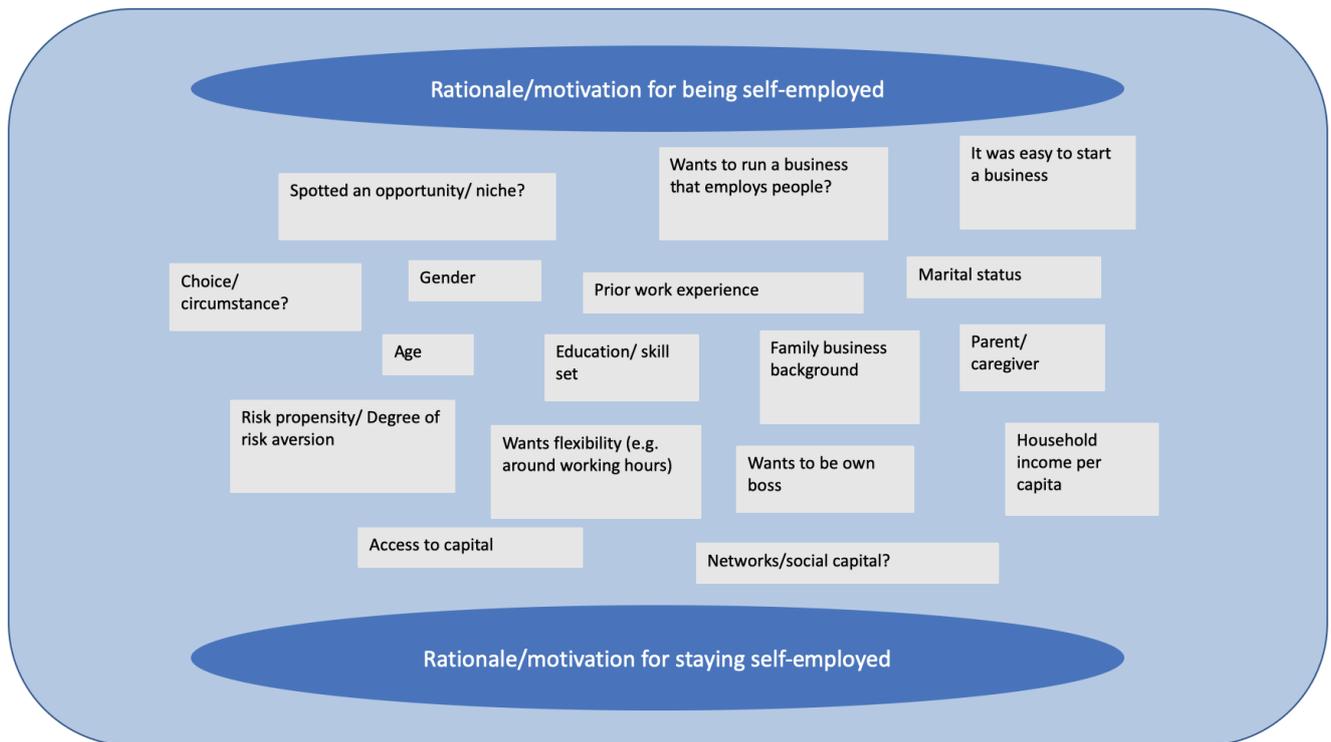
# New perspectives on informality: a focus on the South African context

## I. Introduction

In many parts of the world small businesses are the engine of economic growth. In South Africa, they have never taken up that role. Apart from being an afterthought in the absence of Regulatory Impact Assessments for legislation and registration and therefore sagging under the weight of red tape, SMEs are under-researched and poorly understood. Some use the term to describe the micro and informal sector; others understand it encompasses businesses with as many as 250 employees and include the solo self-employed. As we continue to face the devastating effects of the Covid-19 pandemic and the South African economy finds itself on its knees, we revisit in our suite of papers why the small business segment of the economy has failed to become the beacon of hope and component of growth and inclusivity it is elsewhere on the planet, even as it struggled before the crisis and what can be done to turn the situation around.

It may be useful to consider what should be obvious – that SMEs are heterogenous. All of the decisions depicted below for SMEs – as well as defining characteristics related to family business background, skills set, risk appetite, or access to social capital – affect why they start and continue to run a business and their ability and appetite to grow and employ. We look at some of these as we explore what we call the informal-to-formal continuum.

**Figure 1: Firm/Owner Characteristics**



To tackle the triple challenges faced in South Africa, namely poverty, inequality and unemployment, much of the policy debate – particularly in the last year – has centred around the “informal economy”. But what is often and lamentably missing is a much-needed conversation about how we nurture the larger, medium-sized firms, which are most likely to create employment.

Building new businesses is vital for South Africa given the expectations for micro, small, and medium enterprises to help alleviate the challenges of poverty and inequality. This has been one of the core areas of policy focus in South Africa over the last 20 years – the need to assist jobless persons by directing their efforts into new ventures of self-employment or entrepreneurship – and has taken on a new urgency in the wake of the pandemic. The approach has resulted in mixed outcomes, which is worrying for the future.

We look at the conventions for the two distinct groups in the economic landscape to identify appropriate policy choices. The groups – formal and informal businesses – have largely the same goals – to make a profit from the delivery of services and goods. And yet some policy makers and broader societal

commentators would argue that a choice needs to be made between these two groups in almost a binary fashion where Formal = Good and Informal = Bad. These binary concepts are misleading. Where “formal” does business with contract and legislative oversight and protection, “informal” does business with little oversight and almost no protection. Furthermore, flattening these two groups into binary choices belies the very basic rights to enjoy economic freedom and endeavour to build sustainable livelihoods be that through “informal” or “formal” means. So, what do we mean when we say informal and formal?

## **Formal versus informal – it’s not an either or**

According to the International Labour Organisation (ILO), “the informal economy encompasses all economic activities by workers and economic units<sup>1</sup> that are - in law or in practice - not covered or insufficiently covered by formal arrangements.” Or put slightly differently by the African Development Bank (AfDB), “the informal economy is broadly defined as those economic activities not subject to government regulation or taxation or protection”. These concepts are important characteristics defining the ‘informal economy’ as one not fully covered by regulation, taxation or protection (social security & rights). At the same time, many ‘formal’ firms elect not to fully comply with the (sometimes hundreds of) regulations relevant to their sector or turnover or number of employees. An ‘informal’ enterprise may keep books, have a bank account, employ people, but not be registered as a business. In any event, neither formal nor informal businesses were protected from the economic devastation caused by Covid-19 with very few businesses receiving relief in the form of grants (first prize), or loans.

The lead economist at the AfDB describes the informal economy as something around which there are multiple prejudices. “Some associate it with lost revenue, unfair competition, low productivity, human rights abuses and environmental degradation; while others associate it with entrepreneurship, flexibility and resilience. But there is growing recognition that they can also be more innovative, resilient and resource-efficient than their formal counterparts.”

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<sup>1</sup> In line with Recommendation No. 204, “economic units” in the informal economy include: (a) units that employ hired labour; (b) units that are owned by individuals working on their own account, either alone or with the help of contributing family workers; and (c) cooperatives and social and solidarity economy units. For more details refer to: [https://www.ilo.org/ilc/ILCSessions/previous-sessions/104/texts-adopted/WCMS\\_377774/lang--en/index.htm](https://www.ilo.org/ilc/ILCSessions/previous-sessions/104/texts-adopted/WCMS_377774/lang--en/index.htm)

Generally, as we have suggested above, a firm operating in the formal economy is an organisation that is registered, employs, pays tax, and so on. Whereas an informal firm is seen to be operating below the radar, sometimes pegged as something illegal, and often looked upon with disdain. To be a formal business is painted as the ultimate goal that informal businesses should be aspiring to, as it is associated with a form of legitimacy (social and economic) whereas the informal is seen “as secondary, incomplete and unvirtuous” (Karki et al, 2020). South Africa has seen numerous drives to formalise businesses in the past with mixed results given that government has its own reasons to encourage formalisation, which are not always harmonious with why a business would want to move along the continuum.

“The expression ‘informal economy’ encompasses a huge diversity of situations and phenomena. There are a wide range of varying economic, social and political factors that affect the size and nature of the informal economy. Indeed, the informal economy manifests itself in a variety of forms across and within economies. Formalisation processes and measures aiming to facilitate transitions to formality need to be tailored to specific circumstances faced by different countries and categories of economic units or workers.” – ILO

Recognising that most firms cannot be neatly grouped into one or other category, we envisage them in a continuum, where firms sit somewhere along the road from informal to formal; a “grey space” as described by the OECD. Many firms operate on the informal side of this continuum and are slowly moving towards a greater degree of formality in one sense or another. And apart from companies listed or seeking a public ownership on a stock exchange with rigorous guidelines for compliance, very few operate with a ‘fully’ formal status. And as we know all too well, even those fully compliant may not act with a fully ethical spirit. It is impossible to formalise away risk. However, as described by Women in Informal Employment: Globalising and Organising (WIEGO), the transition from informal to formal is made up of “gradual, ongoing and incremental” steps, through developmental actions and more sophistication introduced into the enterprise.

## The informal to formal continuum

Shifting firms towards greater levels of formality should assist them to become more successful and productive, able to contribute positively to growth and employment. In theory, this transition is meant to come with a slew of benefits, most importantly perhaps is access to social protection. There are also considerable costs involved, including paying tax, licence fees, and the time it takes to comply with regulations. In South Africa there is much focus on compliance, but less so on ensuring greater access to benefits so that the costs outweigh the benefits. A case in point is around when small firms tried to access Covid-19 relief from government – see Box 1 : Focus on compliance limited relief.

### **Box 1 – Focus on compliance limited relief**

Many of the informally self-employed who most needed the support could not access it from government with the onerous requirements demanded. For example, people receiving a childcare grant could not qualify for relief, even though many of the informally self-employed needed it even more as they could not work and so could no longer supplement the grant they were receiving. In some cases, informal firms formalised just so they could try and access COVID relief, with all the costs that implied, but still did not manage to qualify for assistance. Many did not even try to register given the burdensome requirements: an operating licence from the local municipality; registration with the CIPC, the revenue authority SARS and Unemployment Insurance Fund (UIF). In a previous paper in our reflection series we noted, this, as well as the poor performance of government’s loan relief support to South African small businesses. By contrast, the private sector provided a bit of a lifeline in the form of financial relief funds donated and managed by the private sector e.g. the Sukuma Relief Programme. This approach also meant that firms did not have to be burdened with debt in addition to just trying to survive.

Without clear benefits, small businesses have little incentive to formalise, particularly for ‘survivalist’ businesses formed here and in other parts of the world because there are too few jobs in the formal sector.

The result is that the informal sector remains a large part of many developing economies. It is thus not surprising that there is a lot of focus on “transitioning people from informal to formal”. The problem is that there is limited evidence that shows that this is working.

A study by the World Bank points to the possibility that what is needed to improve transitions to formality is better targeting; in reviewing the success of set of reforms introduced in Benin it was found that those that succeeded did so because a more narrowly targeted approach had been adopted (International Growth Centre Blog, 2017).

**Box 2: Lessons learnt**

Benin embarked on an “entreprenant” initiative whereby local commercial law was changed to allow for SMEs to register for this new status in a way that was easy, free of charge, and takes only one business day. At the same time, they have been testing whether offering supplementary services does indeed realise more benefits to exceed the costs. Their findings seem to provide only more fuel to the “why formalise?” fire.

Even offering a more comprehensive package of support services, such as access to government business training programme, tax compliance support services and support to open a bank account, more than 80% of firms surveyed elected to remain informal. They also found that “formal firms are not significantly more likely to obtain business bank accounts or loan financing, do not gain more customers, and have no significant gains in sales, profits, or standard of living”. In addition, offering additional services to these informal firms was more expensive relative to business profits and to the tax the government could expect to collect from these firms. The study did find that targeting certain groups enabled more success encouraging informal enterprises to formalise, e.g., women are less likely to formalise than men and those without secondary education are less likely to formalise than those with secondary education.

It is clear that policy making cannot adopt a one-size-fits all approach. There needs to be a nuanced understanding around the different kinds of firms operating along the informal-to-formal continuum so that targeted support can be crafted for different groupings and types of firms at different stages in their lives.

A narrow policy focus in South Africa also means that we are missing the potential that some may offer as they move along the continuum. For example, self-employed people only registered for tax and growing, or entrepreneurs with a good business idea without the skills to craft a business plan necessary to commercialise.

## Vulnerability

The small business space is becoming more complicated. The informal-to-formal continuum includes people who are self-employed but may have access to different kinds of income streams. This is a characteristic of the new world of work where there are increasingly more complex employment scenarios given the introduction of non-standard forms of employment. A case in point is the so-called gig economy. In this context, people move into and out of different employment scenarios all the time, often by choice; sometimes even into and out of unemployment which can land them into more or less vulnerable employment situations. Increasingly personal characteristics around issues such as skills make the difference in terms of whether a person is more or less vulnerable. For example, it is clear that people with very specialised skills sets or multiple skills sets are more easily able to successfully navigate this dynamic, but uncertain new world of work<sup>2</sup>. Those with fewer unique skills sets must compete for work. Just compare a computer programmer with good managerial skills, to an UBER driver; a good business writer to someone who bakes (even delicious) cakes.

Appropriate, targeted policy requires very different kinds of approaches. The former business person (a more skilled worker) should be regarded as someone who is more likely to contribute to growth and employment, for example, if encouraged to expand through certain enticing incentives such as favourable financing terms or regulatory holidays to encourage employment. This suggests focusing on businesses in labour-intensive sectors, as well as ensuring that better social protection is afforded to the business owners. The approach to the small business sector, in which all firms lie somewhere along the informal-to-formal continuum, needs to be holistic. A narrow approach focusing only on specific segments that are important from a development perspective is unlikely to yield the kind of economic growth and employment that South Africa needs. South Africa requires a greater understanding of this segment of the economy to identify where potential to grow and employ lies, as well how we catalyse specific beneficial activities.

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<sup>2</sup> See for example: Making the Most of Talent in the Gig Economy. <https://www.harvardbusiness.org/making-the-most-of-talent-in-the-gig-economy/> ; The great sustainable reset: The new world of work after the pandemic. <https://www.weforum.org/agenda/2020/06/the-new-world-of-work-after-covid19-sustainable/> ; Hyper-Engaging Your Hyperspecialists. <https://www.harvardbusiness.org/hyper-engaging-your-hyperspecialists/> ; Hybrid Jobs Need Hybrid Learning Experiences. <https://www.harvardbusiness.org/hybrid-jobs-need-hybrid-learning-experiences/>

In essence, the concept of formalisation needs to be looked at through a new multi-dimensional lens. Consideration should start from the proposition that there is really no such thing as an informal business, rather the degree of its formality. Currently, the process of defining where a firm is deemed to fit on the informal to formal spectrum is designed and driven by governments. In South Africa, as discussed, formalisation entails registration and various compliance requirements. It also begs the question of whether moving businesses along the spectrum in an inorganic fashion is an effort worth making; no country will ever be without informal, survivalist businesses and as businesses grow and learn for themselves how formalising advances their commercial interests, they will climb the next step willingly.

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What is clear however, is that firms, be they deemed informal or formal, have the same objectives with the entrepreneurial focus on the business of the business. One group may have greater sophistication and protection while the other leverages any opportunity they can seize to make a living. Whether firms are formal or informal, the business of government, on the other hand, is to ensure that it is playing a facilitatory role in enabling a thriving small business environment, which will accommodate both informal and formal firms.

## II. Understanding the murky world of Informality

As described by the AfDB, the informal economy (if we can in fact segment the economy of a country) is “messy and complex”. People and enterprises engaged in the informal economy usually operate on a small, if not micro, scale. It is thus quite hard to measure, as explained by the IMF, and so its size is estimated. Even these estimates show informality affects many people. Whilst it is most prevalent in developing countries, informality exists in all countries. It is also recognised that most people are operating in the informal sector not only by choice (though many deliberately reject the bureaucracy and compliance required), but by necessity due to the lack of opportunities in the formal economy and in the absence of other means of livelihood (ILO: 2018). In South Africa this is largely seen in what is colloquially termed the “township and rural economy” - a particular challenge consequent on the country’s segregated past where disproportionate investment in spatial development occurred and still continues. However, informality is often found in close proximity to the formal economy. This is not a novel idea as these enterprises gravitate to economic opportunity where there are available markets for their goods, produce and services (NPC Study, 2017).

For retail-focused or small businesses providing services, their natural customer base would be the people living in the area. However, many of their neighbours are poor and have limited disposable income, which they spend on a predictable basket of goods. This affects their ability to leverage off the size of the market opportunities. Also, it nudges the informal economic actors directly into competition with formal providers who often enjoy economies of scale to reduce costs and prices in the delivery of basic goods and services.

Due to the sophistication and developed corporate sector South Africa has the ability to distribute their products nation-wide efficiently and cheaply. This contrasts to other developing countries where local small-scale producers are often making and selling items sold in local markets because of the absence of larger businesses. In South Africa such small-scale producers struggle to compete with the big brands across a number of aspects: price, packaging, brand-recognition and consumer habits. Moreover, informal retailers provide the final point of distribution for many of these products, which large-scale producers recognise and are cultivating. This creates a significant challenge for price-sensitive consumers and highlights the challenge for informal players to access market opportunities due to the close proximity of

malls to which consumers go if they need something (e.g., school uniforms) to get the cheapest price. Small producers also find it enormously difficult to compete with payment terms when it comes to larger ticket items, such as furniture, where retailers at the mall offer hire-purchase payment terms (Philip, 2018).

Not all informal enterprises operate in the retail landscape, of course, though we learned just prior to lockdown that AfricaScope estimated the size of the FMCG market in South Africa as between 280,000 and 370,000 outlets (formal and informal, from ‘tabletops to brick and mortar outlets’). For example, Rogan and Skinner (2017) find that workers in the informal sector include: street and spaza shop traders, taxi drivers, construction workers, educare providers, waste recyclers, tailors, shoe repairers, mechanics, and others (IEJ, 2020). Not only is there heterogeneity among firms in the informal sector, but there are also a high number of new firms entering the sector annually and existing firms who are contributing to employment (Fourie, 2018). This nuanced landscape calls for the need for a different perspective in relation to the sectors of the services or the products they deliver their work.

Marusic et al (2020), a group of researchers from the World Bank Group, call for a “re-think” related to the factors driving informality and the need to acknowledge that there is a much greater degree of heterogeneity among firms in the informal sector than is often taken into account. There are a variety of factors that influence a firm’s decision to formalise, ranging from “business culture, individual business characteristics, institutional structure, market conditions, costs of doing business, labour skills, etc.” Given the limited data and literature available related to these aspects, we conclude it is not possible to put in place a transition to formality in a way that maximises the generation of benefits for those involved.

In particular, without sufficient data to understand the characteristics of firms operating at different degrees of informality and their context, policy makers will battle to answer the simple question we were asked by a group of informal businesses: why should we bother to formalise?

Useful techniques such as the application of behavioural psychology to understand why firms get into business and stay in business, why they employ or do not, is often cited in international literature. New technology also provides us with an opportunity to better understand small businesses. For example, the

IMF is using night-time lights from satellite images, to estimate the true size of the informal economy<sup>3</sup>. The Seriti Institute, a local NPO uses GIS Mapping to provide an informative picture of what is happening at community level, for example around local food systems and where small holder farmers are situated, as well as where markets are.

Similarly, having a universally accepted classification of different businesses that fall within the informal sector is key. We need differentiated and targeted approaches to grouping businesses based on their willingness and/or capacity to formalise. Marusic et al (2020)

The World Bank also examines informality from three profiles: Legal, Fiscal, and Labour. Legal informality, they say, often refers to whether the business is registered or not; fiscal informality to the extent the businesses pay taxes, have bank accounts and maintain bookkeeping; and labour informality reflects the use of contracts and benefits made available to employees. These are not exclusive of each other and businesses may be informal across any or all of these dimensions.

As mentioned above, underlining this approach is the need for good data. Whilst the informal sector is complex and hard to measure, we need a more evidence-based picture of what is happening within it. Similarly, we need to have a better handle on the size and composition of the small business segment, within which many of these small informal businesses are also included. We need more and better data, that is up to date and comprehensive.

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<sup>3</sup> <https://blogs.imf.org/2019/10/30/the-global-informal-economy-large-but-on-the-decline/>

### III. South Africa: Policy support, or lack thereof

The IEJ (2018) highlight that analysis of policy responses directed at the informal sector, across all three spheres of government, shows that “there has been a mix of ambiguity, omission, but also repression” of enterprises operating in the informal economy. Predominantly policy has assumed SMEs need above all micro-finance, training and (sometimes, but not often enough) the removal of regulatory constraints. In extreme cases the policy approach has resulted in harassment.

While the informal economy is targeted mostly for formalisation compliance the actual development of the informal sector is an add-on, given low policy priority and insufficient resources (human and financial) allocated to this by respective departments. Local government is particularly critical for the development of these micro enterprises and yet local authorities often have an ambivalent attitude towards those working informally as it is not in line with ideals related to progress towards modernity (IEJ, 2018). Hence much of the work is often targeted at compliance to either formalise, or enforcement where trade is regulated haphazardly. The paper in a suite of papers, conducted for the research study discusses the low priority of Local Economic Development places in reality on adequate SME support.<sup>4</sup>

Some of the key policy or programmatic areas attempting to assist the informal sector are discussed below. The South African economy was already on a difficult footing prior to Covid-19; with the current reality it has become even more critical to review current policy approaches related to small businesses, including informality.

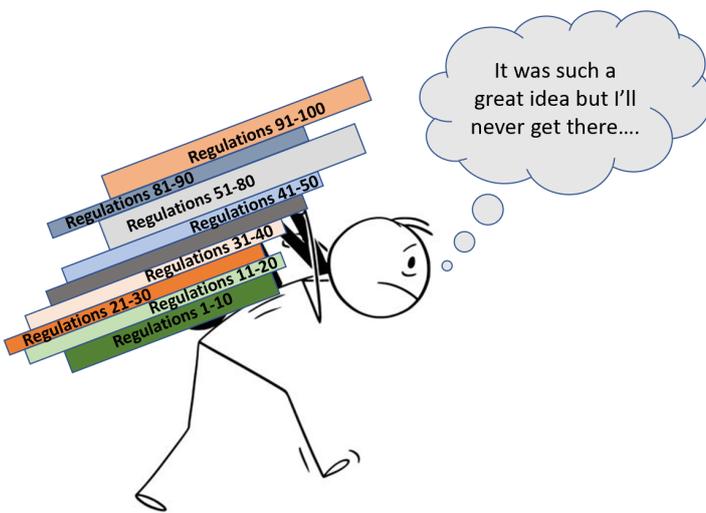
For a healthy, growing economy, there needs to be a thriving business sector. Worldwide it is acknowledged that small businesses play a vital role in this regard. In our digitalisation reflection paper, “Digitalisation – the best hope for South Africa and its small firms”<sup>5</sup> a paper in the suite of papers for

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<sup>44</sup> SBI 2021 “Importance of Local Champions in Reviving Local Economies” a paper in the suite of papers for this research. See SBI website: [www.smallbusinessinstitute.co.za](http://www.smallbusinessinstitute.co.za)

<sup>5</sup> SBI 2021 “Digitalisation – the best hope for South Africa and its small firms” accessed on [www.smallbusinessinstitute.co.za](http://www.smallbusinessinstitute.co.za)

this research, we clearly saw how there were many small businesses that innovated and thrived enabling them to navigate the Covid-19 disaster that sent the South African economy over the edge. There is a vital pool of entrepreneurial talent in the country that needs to be identified and supported. Not everyone is an entrepreneur, many people just want a job. But for those with sufficient grit to start a business, especially one that is digitally enabled, understanding the smaller segment of the economy and facilitating its path to sustainability should be the first focus for government.



The overt focus on formalisation and compliance quashes entrepreneurial spirit. The sheer number of regulations disincentivises people to even try to get their idea off the ground.

In the small business sector, we need a combination of firms: some will contribute to poverty alleviation, some to employment, some to growth and inclusiveness, and some to all three.

## Fixation on registration

What is the policy approach to informalisation in South Africa? Over the last year in particular, the emergence of an overabundance of databases on which SMEs have been asked to register has become a key aim of different government agencies; whether this is for monitoring or compliance reasons, it is unclear. We have repeatedly called for better data collection and information on which to base fact-based policy, but to date this has not been voiced as a stated objective for these various efforts to capture the details of SMEs. Further, there has been little evidence – even anecdotal – that SMEs have anything to gain by registering on any database. The Department of Small Business requirement to register, for example, during the pandemic led the owners of small firms to believe they would receive grants to tide them over. But the minister has recently explained that the scheme, administered by the Small Enterprise Finance

Agency (sefa) had ‘reprioritised’ R500m for SMEs in distress. Over 35,000 applicants attempted to register, yet only 14,451 completed their applications. In the end, 1,497 can expect to end up with money in their pockets, but thus far (as at January 2021) only R316-million of the R513-million allotted for disbursement has been released.

## **Consideration of employment potential**

The National Development Plan (NDP) sets out several ambitious goals for SMEs, including a target for 90% of new employment opportunities to be created by SMEs by 2030, a mere nine years away. A number of these jobs – some two million – are expected to be created in the informal sector (including domestic work). Nothing in the plan, however, explains how this will happen. No proposals are articulated for this sector (Fourie: 2018). SMEs were an afterthought in an otherwise granular and detailed document.

Employment targets – and entrepreneurship as a means to employment – seem to be centred on creating small firms and cooperatives out of necessity, or “forced entrepreneurship” and mopping up the remaining unemployment through public employment programmes<sup>6</sup>. Government sees itself as a key driver of the employment creation agenda. Is this really how it should be? We have to question the soundness of policy direction when it includes equating starting a business with having a job<sup>7</sup>. Similarly, government aims to solve a large part of the unemployment challenge through increased public employment programmes, when rather it is the private sector which creates jobs and drives economic growth in any country.

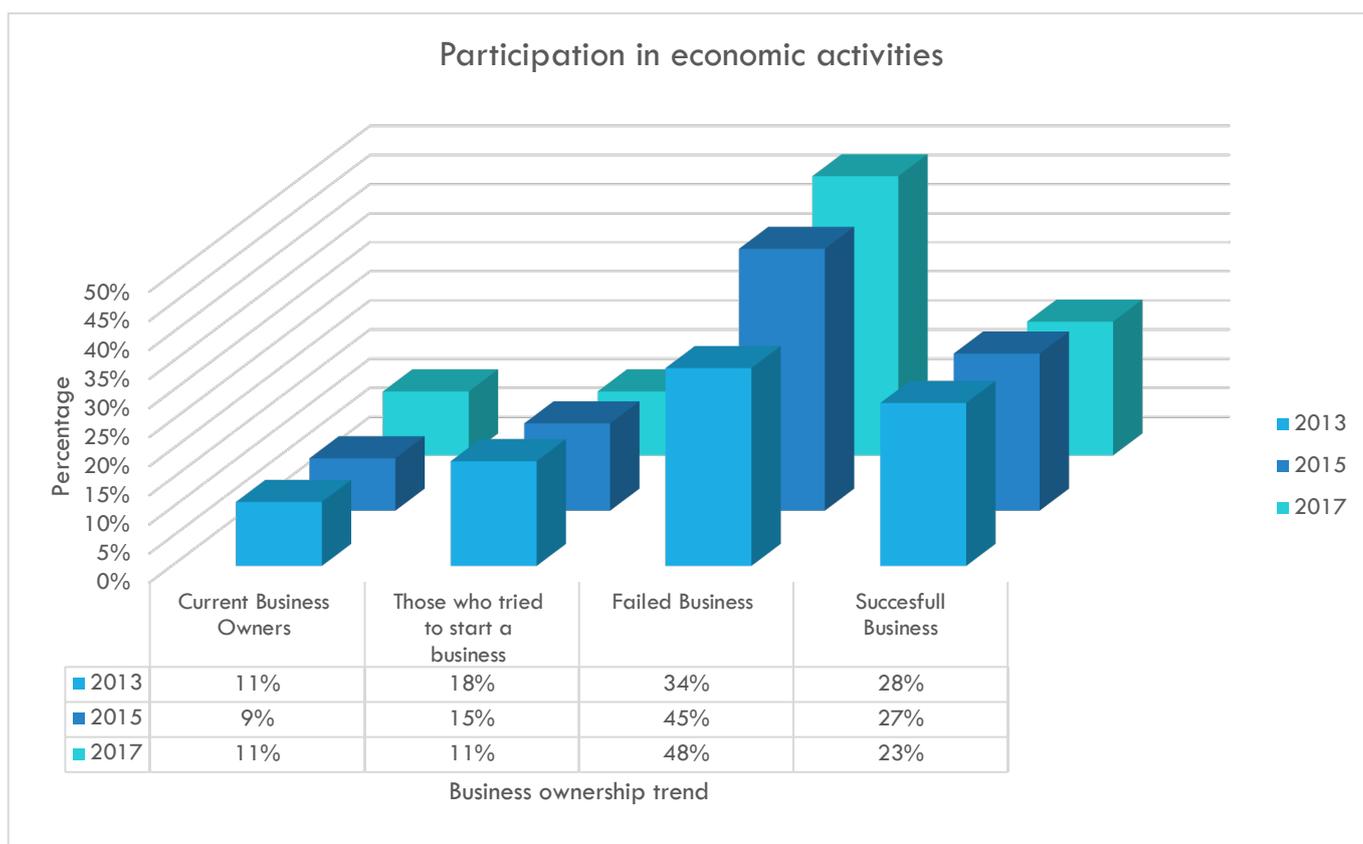
Most people in South Africa, if given the choice, would want to have a formal job. South Africa’s Survey of Employers and the Self-Employed (SESE: 2017) shows that most of the people who are informally self-employed are not in this position by choice. They started a business because they had no other options. Add together the number of people who do not have the means to become self-employed (the unemployed) to those who have given up finding employment or doing anything (the economically inactive); for a sense of how enormous this challenge is. There are simply not enough job opportunities for

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<sup>6</sup> The NDP proposes that about half of all unemployed will eventually be absorbed into community-based Expanded Public Works Programme (EPWP)-type service jobs that are focused on deepening service delivery.

<sup>7</sup> For more information refer to StatsSA definitions of unemployment in the Quarterly Labour Force Survey

everyone along this informal-to-formal spectrum. Even before Covid-19 the country’s unemployment rate was deeply worrying and all small businesses (formal and informal) were having a tough time surviving. Information taken from the Gauteng’s (the largest economic region in South Africa) Quality of Life survey indicate that business ownership trends are flat with reduced successful businesses and increased failure. Without an urgent focus by government to make it as easy as possible to start, run and grow a business, no number of databases will give us good news, or new businesses; they will only enumerate shrinking numbers.



Source: Quality of Life Survey – Calculations made from dataset downloaded from Datafirst

Many who are self-employed have different motivations around why they became self-employed (out of choice or necessity, are two), as well as why they remain employed and perhaps even seek to grow and employ.

Most are solo self-employed i.e., do not employ. They each face their own sets of challenges depending on the sector they operate in or the profile of the business owner.

We reiterate: it is critical, from a policy perspective, to get to grips with some of these key distinctions, particularly with regards to how this relates to the informal sector and how/whether interventions can support SME sustainability.

### **Informal self-employment: diverse and nuanced**

We have discussed above that the informal sector is more diverse and nuanced than is generally considered. There is a plethora of research and opinions around what is happening in reality.

For example, the widely held belief that most informal enterprises are survivalist does not hold up to scrutiny. Based on data from 2013 research undertaken by Frederick Fourie (Research Fellow, University of the Free State) found that around four-fifths of informal enterprises in South Africa last more than 12 months (CDE: 2020). This appears to be backed up by the most recent SESE, which shows that “approximately 95 per cent of informal business owners had only one business, and the majority of them have been operating the business for five years or longer”. It is acknowledged, however, that new informal sector firms are fragile and can quickly fail. They are especially vulnerable to external shocks, such as the Covid-19 pandemic (CDE, 2020). Further, South Africa has low levels of entrepreneurial uptake (GEM, 2020). Nevertheless, unlocking growth and employment potential within the small business sector, wherever it lies, is a crucial step to catalyse positive change within the South African economy.

### **The (growth) enabling environment**

As already discussed, much of the engagement of government with small business has to do with regulatory compliance, which for informal businesses often manifests in punitive ways, such as harassment or confiscation of goods, let alone the time it takes away from the business, access to computers or data, the cost of traveling from pillar to post.

The African Development Bank emphasises that formalisation should not focus on controlling and regulating but on enabling and supporting enterprises. We agree. This may require some formalisation

through incentivising registration or licensing, for example, so that the firm or owner can access a bank account, or what limited government financial support is available. But we would add a word of caution here: It is reasonable to perform a skills audit and offer subsequent assistance by government issuing taxpayer-funded grants or loans to SMEs to help the recipient and protect against default; it is also unquestionably government's role to provide basic services like electricity, reliable and available bandwidth, infrastructure like good roads, streetlights and the protection of the public's safety. However as discussed in two of our other papers, the public sector lacks competence in much of this. An added disadvantage SMEs face are the dismal 'learning outcomes' after 27 years of supposedly more equitable schooling. The number of students who do not/cannot complete matric is unacceptable. Early childhood education and other interventions are indeed the responsibility of government, to promote a literate and numerate population and expand access to tertiary education where young people will acquire the skills of the future.

And so, while studies have shown that rather than focusing explicitly on regulatory formalisation the focus of policy should be to make emerging firms more robust and less vulnerable (Fourie, 2018), we would question conclusions that informal firms be offered *remedial* support by agencies of government when government's schools should have provided adequate knowledge and skills in the first place. Similarly, while *access* to formal facilities and other infrastructure is vital, we would urge care in deciding how best limited resources are allocated to improving business skills and whether the public or private sector is more equipped to offer valuable help. Ultimately, assisting these aspirant entrepreneurs to access formal means to deliver their goods and services rather than just the "compliance certificate", which often comes at a high cost, is a laudable goal.

According to Fourie, enterprises that have secure facilities, access to water, electricity, and the internet with skills to undertake proper stock control, are much more resilient and prone to growth than those that do not. For these reasons "policy must focus on enablement and not on compliance". From this perspective, strengthening firms to become more capable may lead to more formalisation, rather than the other way around. Furthermore, being formal should not be a prerequisite to participate in programmes to assist enterprises. In addition, he reminds us that formalisation is not an option unless the costs of running a formal business are lowered. South Africa's cost of doing business has been worsening over time likely due to the burdensome regulatory environment (CDE, 2020). See more about the effects of regulation not

just on informal businesses, but formal micro, small and medium enterprises in our paper **Tackling the “Disabling Environment” to boost economic growth, small business & jobs**

Other analysts support enabling rather than policing informal businesses especially and urge municipalities to play a leading role in providing water points, ablution facilities, electricity points, sorting sites for waste pickers, and other kinds of enabling infrastructure (CDE,2020). We would also add universal Wi-fi and alternative energy sources. Therefore, a key requirement for answering why formalise? is getting the basics right i.e., delivering the services businesses need to trade.

The Institute for Economic Justice (2018) underlines that a systemic change is required, based on a deeper understanding of the inherent dynamics of the informal sector, but first IEJ calls for government to “do no harm”.

#### **IV. Conclusion**

At a high-level South Africa says the right things to advance the rights of and support to SMEs in the informal economy (often to the neglect of what should be done for larger or formal small businesses), but there is a regrettable absence of serious political action beyond the drafting of agreements and plans for all segments. For instance, limited commitment and limited resources have been directed to advance the implementation of ILC R204<sup>8</sup>, which included a roadmap of actions that was crafted following a National Dialogue held by the ILO in March 2018, as well as a SALGA (South African Local Government Association) initiative to develop guidelines for the informal economy in the 257 municipalities who are their members (IEJ, 2018).

We suggest it is important to adopt a harmonised, multi-departmental and multi-tiered approach when imagining the purpose of and incentivising a transition from informal to formal for small businesses. The

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<sup>8</sup> International Labour Conference Recommendation No. 204 concerning the Transition from the Informal to the Formal Economy. For more details refer to - [https://www.ilo.org/ilc/ILCSessions/previous-sessions/104/texts-adopted/WCMS\\_377774/lang--en/index.htm](https://www.ilo.org/ilc/ILCSessions/previous-sessions/104/texts-adopted/WCMS_377774/lang--en/index.htm)

Institute for Economic Justice highlights how local government, in particular, has an important role to play to support small business. We explore this more in two other papers in this suite – “Tackling the ‘Disablement Environment’ to boost Economic Growth, Small Businesses and jobs” and “Digitalisation – the best hope for South Africa and its small firms”<sup>9</sup>. Specifically, their suggestions relate to aspects such as:

- Creating an enabling environment for local economic development.
- Getting the basics rights in terms of provision of energy, roads, water, security and public transport.
- Addressing land use management and other regulatory issues that constrain development.
- Improving connectivity between marginalised areas (e.g., township, rural areas) and the wider economy – including in relation to wi-fi and internet access, which can assist in bridging spatial divides.
- Building partnerships with the private sector.

Corruption also destabilises the business enabling environment and especially in municipalities operating with impunity. Some of the international literature highlights that the informal sector is likely to be bigger in countries where corruption in the public sector is rife – there is a greater incentive to have illicit activities on the go and even less incentive to formalise.<sup>10</sup>

Policy support needs to be crafted holistically taking into account the complex and diverse nature of small businesses. It is also critical to understand the many ways in which the formal and informal economy are intrinsically linked (IEJ, 2018). The informal sector may be ‘messy and complex’, but it, along with formalised businesses above all need to be allowed to trade, rather than hindered from flourishing. A multi-stakeholder approach is required to make this happen and government needs to work in a supportive manner with the public sector. Coordinating policy across different spheres where territorial egos are involved such as competition or labour policy is also mandatory. We’ve said it before: every minister should be a minister of small business. There is no time to waste we need to get going, yesterday.

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<sup>9</sup> Both papers can be accessed on SBI website: [www.smallbusinessinstitute.co.za](http://www.smallbusinessinstitute.co.za)

<sup>10</sup> See, for example: “The determinants of self-employment of black entrepreneurs in Ladysmith, KwaZulu-Natal”. Authors: Siboniso N. Kumalo; Irrshad Kaseeram. Acta Commer. vol.19 n.1 Johannesburg 2019. <http://dx.doi.org/10.4102/ac.v19i1.616>  
Source: [http://www.scielo.org.za/scielo.php?script=sci\\_arttext&pid=S1684-19992019000100009](http://www.scielo.org.za/scielo.php?script=sci_arttext&pid=S1684-19992019000100009) (Accessed 10 November 2020)

# Recommendations:

## Develop a compelling reason for, and simplified path to, formalisation

During a conversation with the Phaphama researchers who, early in lockdown conducted a well-respected piece of research of township entrepreneurs, we were told informal business owners saw no benefits in formalising. Not only must government be able to answer this question, but it must also communicate its rationale and demonstrate that the benefits for SMEs outweigh the costs. As we have discussed, businesses will formalise when it is easy, inexpensive and will advance their commercial interests.

**Developing a deep understanding of the various needs of businesses as well as wide consultation should be prioritised.**

Invest in infrastructure: We have highlighted the importance of access to infrastructure, both physical and digital. Governments play the lead role in developing and awarding infrastructure projects to the private sector from water management to renewable energy to pothole filling. Perhaps tellingly, the Vison 2030 website, which once had a reference to the role of infrastructure in building the economy is no longer live. Additionally, as the evidence shows, many informal workers trade from their homes, which also suggests a different approach to town planning and settlement design is needed in the areas (Skinner et al, 2018). The shift to digital platforms, which we discuss more fulsomely below and is traversed in the Digitalisation paper <sup>11</sup> for example, offers informal business a way to access new markets, which has been one of the constraints they face. Enterprises can only take advantage of this potential if the infrastructure is available, such as internet connectivity and safe, reliable transportation infrastructure (AfDB, 2020).

Educate and train people to be employable and to run businesses: Formalising requires skills. Many and varied, from literacy to digital know-how, The African Development Bank identifies business extension

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<sup>11</sup> “Digitalisation – the best hope for South Africa and its small firms” paper – access on SBI website [www.smallbusinessinstitute.co.za](http://www.smallbusinessinstitute.co.za)

services “as a potential game changer if successful production techniques are to be scaled up across the country, though again, we would urge public-private cooperation in this regard. The SESE shows us that the education profile of informal small business owners has been changing over time with many entrepreneurs (though not enough) in this group enjoying a higher level of education. As in the formal sector, the less educated will be displaced by those with more skills. Skills will ensure a more productive workforce; a more productive workforce will assist with higher growth and inclusivity.

Institute sweeping reforms for business success: Our paper on Tackling the Disabling Environment addresses this comprehensively and in particular urges the reintroduction of Regulatory Impact Assessments, particularly for how laws affect SMEs. But in respect of informal businesses and workers, policy makers and government agencies at all levels require a mindset shift from punitive to supportive bylaws and regulations. The carrot is almost always more persuasive than the stick. Enforcement too, is heavy handed in some areas and perhaps insufficient in others. For example, a SERI report by Clark (2018) draws from case law and finds that the law grants protection to foreign nationals who participate in informal trade and cautions local government as to the illegality of impounding traders’ goods. Based on this, the report puts forward a set of recommendations to local government including detailing bylaw clauses that need to be changed if current laws are to comply with the constitution. Further work needs to be done regarding the need for regulated access by informal workers to public natural resources like waste, medical plants and fish.

Do no harm: The State contributes to the precarious situation in which many informal operators and workers find themselves. Recalling the multiple incidences where informal workers have been, and continue to be harassed (such as waste pickers) and their goods are being confiscated (Operation Clean Sweep’ in inner city Johannesburg and ‘Operation Hardstick’ in Limpopo, where informal retailers were evicted), or where quotas are decimating livelihoods such as in the case of small-scale fishers, we would call government to cease doing harm.

Access to financial services: Access to finance, SMEs say in nearly every survey, remains a key constraint to growth for many small businesses as a consequence of a combination of onerous requirements and a naturally risk-averse banking sector. Often, business owners need to provide some collateral or surety when applying for a loan, but they do not have anything to offer, including security of tenure of land (NPC

Study, 2017). GG Alcock (Marketer and Author of KasiNomics) also notes that “many of the large banks, they say they are not geared to give R5,000, R10,000, R25,000, or R35,000 – it will cost them more to extend that loan than the actual loan amount”. This challenge means that there is space to explore how to increase access to financial services for this key part of the economy (CDE, 2020). The Institute for Economic Justice calls for further pressure to be placed on the banks to increase their coverage, but we need to look beyond traditional banks as part of the digitalising world. Alternative smart contracts assist with cash flow and many e-commerce platforms allow SMEs supplying their customers to use outstanding invoices as collateral for micro loans, for instance.

Social protection reforms (inclusive of Occupational Safety and Health): Another reason people chafe at the idea of formalisation was revealed as one of the cracks in the Covid-19 with relief offered – but so little granted – to small business owners. For example, women could not access it if they also received a child support grant. Own account workers remain excluded from all forms of social protection that are dependent on an employment relationship, such as access to the Unemployment Insurance Fund. Reforms should include de-linking eligibility for support services as an individual from their registration as an enterprise.

Finally, Enable new pathways – think digital: As this paper demonstrates, South Africa needs to find new and innovative ways to integrate the informal and formal economies over time. Mobile/digital technology is one such avenue. Research has shown that in many countries, especially countries with vulnerable economies, productivity increases by more than four percentage points for every 10% increase in cell phone penetration, while GDP grows by half a percentage point when mobile-data usage doubles (Economist, Dec 2016)<sup>12</sup>.

Training programmes on mobile technology that have targeted informal township entrepreneurs show that there is an immense appetite and need for the digital economy. Many of these are being spearheaded by the private sector, or public-private partnerships. As of mid-2019, almost 100% of township entrepreneurs participating in a study on mobile use technology, owned smart phones and use the

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<sup>12</sup> The Economist, 10 December 2016: “Mobile phones are transforming Africa where they can get signal”.

WhatsApp platform. Yet, it was found, even the most basic and free digital marketing tools are not fully understood or used, so wider-spread training is needed in digital marketing, digital business systems, crypto currency, cyber security and e-commerce<sup>13</sup>.

As one of the papers in this suite of research that focuses on “Digitalisation – the best hope for South Africa and its small firms”<sup>14</sup> – shows, there is considerable enthusiasm among informal and township business owners to embrace digitalisation and use of digital technologies (mobile technology specifically) for business purposes. From marketing and selling products on platforms as accessible as Instagram, tik tok, FaceBook to any of the 104 digital marketplaces available in South Africa to South African ingenuity developing medtech and edtech products (some ‘wearables’), our entrepreneurs will – as with so much in economies – be driving recovery, growth and the leap into the fourth industrial revolution.

### Box 3 - Innovative entrepreneurship at work

There are many examples of the digital pivot SMEs took during Covid-19 in our paper on digitalisation. GG Alcock (Marketer and Author of KasiNomics) also noted how the informal sector can be seen as more agile and dynamic than the formal sector precisely *because* they are less encumbered by regulations. He cites the example of a bakery in White City, Soweto shifted to selling on WhatsApp and delivering in a trolley using pin locations. Tracey Chambers, CEO of the Clothing Bank, a project that supports women in marginalised areas to become successfully self-employed, highlighted how these women continued to market and sell their merchandise to their clients using WhatsApp.

Given the highly competitive environment in which localised entrepreneurs find themselves, their challenge – as for all businesses - is to find ways to differentiate their products by adding value (such as convenience) and identifying niche market opportunities. With changing consumer preferences and levels of disposable income, new opportunities are constantly presenting themselves. For example, Khayelitsha’s Department of Coffee sells cappuccinos to commuters at the station on their way to work. Similarly, some consumers are willing to pay more for live chickens than the frozen variety that is available in the supermarket. Fresh produce, locally grown, can also short-circuit long supply chains. With Covid-19, there is a renewed appreciation for local supply of fresh produce and commitment to strengthening local food systems. Other examples, also demonstrate that small business does not have to be limited to local markets. Craft beer Soweto Gold, even before being acquired by Heineken accessed markets in Johannesburg’s upmarket northern suburbs.

Mobile Information and Communications Technology (MICT) is at the core of the 4IR. In the last few years, South Africa’s smartphone penetration deepened. In 2017 it was found that 88.2% of SA households use

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<sup>13</sup> [www.kayafm.co.za/south-african-digital-users/](http://www.kayafm.co.za/south-african-digital-users/)

<sup>14</sup> “Digitalisation – the best hope for South Africa and its small firms” paper – access on SBI website [www.smallbusinessinstitute.co.za](http://www.smallbusinessinstitute.co.za)

only cell phones as a means of communication. But affordability remains an issue and affects internet penetration levels, which decline as income levels decline (worldwideworx, 2017). Generally, it is found that SA consumers pay more for broadband services of lower speeds than other emerging economies in Africa and other regions.

Internet access is fast becoming synonymous with economic access but high internet and data costs affect the overall competitiveness of the economy – formal and informal – and constrain the development of e-commerce.

### **Further Recommendations related to the 4IR**

Tackle the high costs of data and increase access: The cost of data is a major obstacle. Key technologies such as blockchain, datamining and video are broadband intensive and will have limited benefit for informal businesses especially, unless these costs can be brought down and access is broadened. For this to happen, roll-out of spectrum at affordable prices must be the imperative government claims it is. We release this suite of papers on the latest target they set themselves to detail the auction process.

Access to free, or more affordable, Wi-Fi: Local authorities could extend free, or more affordable access, to Wi-Fi in places where informal operators congregate and are concentrated such as high streets, major taxi ranks and other places. Roll-out of Wi-Fi by local authorities to their local communities could advance economic revival in small towns and rural areas.

Work with the private sector to hasten the adoption of renewable energy: Without adequate power, use of technology and the access to new markets for small farmers through to the internet of things offering smart water meterage and better security will be compromised.

Promote mobile learning platforms: Online learning platforms are an innovative way to help support small business owners particularly operating in township and rural areas who have already achieved entry-level

digital literacy. They are also an inclusive tool to address the education and skills gaps, digital and otherwise, afflicting so many unemployed and unemployable South Africans.

Online learning – much of it free – offering a full spectrum of business support services (such as business skills development, finance, coaching and mentoring) can take place anywhere for micro learning moments in real-time when coaching is needed. Covid-19 accelerated on-line learning and communication. Virtual reality can make entrepreneurship and training direct, personal and customised at a fraction of the cost of traditional classroom business support training. If, that is, informal business owners are supported by being given better - and more affordable - access to internet connectivity. As one informal business owner noted in a focus group discussion for this research, “we need access to the internet, the rest we can do ourselves” (Bothaville, 2020).

Government (the DSBD in particular) should consider opening digital support centres in townships, small towns and rural areas: Instead of delivering costly business support services through traditional, classroom coaching, government could have a huge impact in helping to modernise the informal economy by rolling-out digital support centres in localities such as townships, small towns and rural areas - just by providing the basic infrastructure to crowd in the private sector as well as other key departments engaged in science, technology and innovation. Corporate business such as technology companies wishing to expand their footprint into the informal economy, corporate social investment initiatives, private sector business support providers as well as community organisations and business chambers or associations could all participate in such a technology hub.

Covid-19 accelerated SA’s use of technology – small businesses, formal and informal, had to increase their use of technology to survive. Mobile technology has the potential to advance every facet of economic development and contribute to finding new pathways to bridging the informal and formal economy divide. But for this to happen it requires out-the-box thinking and new perspectives. Efforts should focus on meeting immediate needs of small business owners, not supply-driven approaches that impose technology solutions based on the limited perceptions of their promoters.

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<https://www.wiego.org/sites/default/files/resources/files/WIEGO-Platform-ILO-2014.pdf>