

## **CHAPTER ONE:**

### **INTRODUCTION TO THE FORMIDABLE PROBLEM OF INFORMALITY**

#### **1.1 Introduction**

The informal economy constitutes an important part of the South African economy. As a result, it has attracted considerable research attention during the past three decades, not only because of its sheer size but also because of its potential role in providing income generating and employment opportunities, particularly for the unemployed. In 1985 nearly two million people were involved in the informal sector in townships and this number has increased dramatically. Rogerson (2000) estimates that there were 1.2 million people in the informal sector in 1998 in Gauteng alone. The informal economy provided almost a quarter of all African income, making up R5, 9 billion or five percent of the Gross Domestic Product (GDP) (Kirsten, 1991). It is quite clear that there is a considerable amount of enterprise and entrepreneurship, in spite of a very low capital base and skills in this sector.

Nattrass (1990) comments that the structural environment confronting emerging informal businesses is one of narrow economic spaces that severely restrict growth. He points out that once these businesses develop beyond a limited range of township specific products and services into sets of activities with greater potential for expansion, they encounter vigorous competition from larger formal businesses against which they do not have neither the resources nor the experiences needed to cope. Nattrass (1990, p. 36) goes on to note that “once business perceives informal business to be, either a threat or an opportunity, it is highly likely that it will use its economic muscle to its own advantage, through either eliminating the competition in the first instance, or through a takeover of the informal business in the second”. Nattrass’s observation affirms that the economic space within which informal businesses operate is to a large degree determined, and in some cases governed by that of the dominant business sector (Krige, 1988). This shows that the possibility of fostering closer linkages between large and small enterprises as a means of supporting the development of informal enterprises has some formidable challenges. These challenges are at the centre of exploration in this research.

Budinich (2005) and Professor C.K. Prahalad, of the University of Michigan Business School also note that two-thirds of the world's population – four billion strong, struggle to survive at the bottom of the economic pyramid, yet they represent a neglected multitrillion-dollar market that is growing steadily in an otherwise turbulent global economy. Budinich points out that some of the world's most savvy multinational corporations are discovering that the poorest of the poor represent the next major frontier for companies that are struggling to maintain rapid growth, which is a huge and potentially profitable market waiting to be tapped. This point suggests that the partnerships between informal and formal businesses can be beneficial to both. *The Sunday Times* (9 March 2008) expands the argument further by noting that “established life insurance firms have failed to take market share from informal burial societies and funeral parlours despite possessing cheaper funeral products and superior distribution networks.” This further illustrates the significance of informal businesses in creating sustainable employment and development of areas where they operate. Also, the confidence it creates in those communities. The next section will discuss the characteristics of the informal sector as well as the methodology used for gathering and analysing research findings for this report.

## **1.2 Characteristics of the Informal Sector**

The informal sector is typically characterized by a strong economic dynamism with rapid entry and exit and flexible adjustment to changes in demand. A large number of small-scale products or services usually owned by individuals or families including those who have recently migrated from rural areas or residing in urban areas but are unable to find immediate employment in the formal sector. Their products and services tend to be very simple. Capital investment is generally minimal and employment relationships are mostly unwritten and unformulated. Workers tend to have very little or no education, they are usually unskilled as well, and tend to learn their skills on the job. In addition, business entities in the informal sector usually have no access to formal financial services, and productivity and wages in this sector tend to be low compared to the formal sector.

Other characteristics shared among informal sector enterprises include “low fixed costs, reliance on family labor, use of informal financial markets for credit, recycling of goods, and lack of wage employment” (Webster and Fidler, 1996, p.10). The informal sector includes three groups

of active participants: survivalists, self-employed, and micro-enterprises. Survivalists are very poor people who generally work in this sector for the purpose of generating an income for survival (Webster and Fidler, 1996). Self employed people produce goods for sale, purchase goods for resale, or offer services. Micro-enterprises are very small businesses that usually operate from a fixed location with regular hours. In South Africa, Skinner and Lund (2003) describes the informal sector as characterized by at least two of the following features, namely small size, as measured by the number of employees; absence of officially recognized business premises; lack of official registration of the business; lack of official records of the business, and lack of easy access to resources in the formal sector.

Most developing economies have a common character: “the existence of a modern urban capitalist sector geared toward capital intensive, large scale production and a traditional rural subsistence sector geared toward labor-intensive, small-scale production” (Todaro, 2005 p.29). Chen (2005) writing from an Asian experience points to how few informal enterprises, except perhaps some survival activities, operate in total isolation from formal firms. Most access raw materials from and or supply finished goods to formal firms either directly or through intermediate firms. She notes that sourcing and supplying of goods or services can take place through individual transaction but are more likely to take place through a sub-sector network of commercial relationships or a value chain of sub-contracted relationships. The point Chen raises is in contrast to what Natrass observes in South Africa. Natrass (1990) notes that competition in the form of sophisticated existing formal businesses is one of the most fundamental obstacles confronting the development of informal businesses in South Africa, especially in the manufacturing, construction and retailing sectors. The latter point is further emphasized by the research done by the World Bank (WB) as illustrated below.

The World Bank’s (1993) research programme on small-scale enterprises and the informal economy in South Africa discerned only a small volume of production and subcontracting occurring currently regarding informal enterprises. In an extensive Human Science Research Council (HSRC) national study on the small scale and informal economy, it was confirmed that sub-contracting only occurs on a very limited scale (Hirschowitz, 1991). However, it is important to point out that these studies undertaken by both the WB and HSRC did not focus on the informal businesses operating in informal settlements. The focus was on informal businesses

operating in urban areas, concentrating more specifically on Coloured and Indian townships. It thus remains a big question to explore how partnerships can be created to address the lack of development in informal settlements.

Rogerson (1993) observes that several factors appear to preclude the evolution of symbiotic business linkages between large enterprises and the South African micro-enterprise economy. One of the significant blockages to the spontaneous and general growth of production subcontracting is attributed to the historical legacy of the “Apartheid Education” system, which denied sufficient technical training to Africans and thus reduced the quality and reliability of subcontract work (Hirschowitz, 1991). Another important characteristic of the informal sector that merits particular attention due to its relevance to the subject of this paper is the lack of partnerships between the informal sector and corporate South Africa. Manning (1993) observes that cooperation between large and small scale enterprises in South Africa in general has not developed to a meaningful extent. Corporate South Africa lacks a culture of cooperating with small firms, and most corporate responsibility for informal development remains at the level of rhetoric. It is vital to point out that in South Africa, the challenge of forming these links is also historical taking into account the country’s apartheid legacy.

The challenges of the lack of partnerships are exacerbated by the fact that South Africa has witnessed massive growth and continued influx of people into informal settlements. Over the last decade, the adopted economic policy approaches to the informal sector have not been the most appropriate for dealing with the problem of urban poverty. The reason behind this situation is that these policies do not emphasize the importance which needs to be placed on the understanding of the broader environmental context that confronts informal businesses operating in informal settlements. Mashigo (1993) notes that the context is one of violence, absence of infrastructure and institutional support, all of which are hardly conducive to the formation of linkages with corporate South Africa. The above point raised by Mashigo is a valid point however I argue that it is an excuse raised by corporate South Africa. The fact of the matter is that often when corporate South Africa stands to benefit from a project in the townships and informal settlements the above mentioned challenges are not a concern. The primary challenge facing South Africa the inauguration of the country’s first democratically elected government in 1994, in urban development has been how the household income streams into informal

settlements can be expanded and grown with the objective to eliminate poor standards of living and indeed the informal settlements themselves. Lauchaud (1987) observes that little attempt has been made to integrate approaches of the informal sector into the analysis of poverty. This discussion brings forward the concern of this research which is to understand the challenges of forming partnerships between informal businesses and corporate South Africa.

### **1.3 Main Research Question**

What are the challenges of forming partnerships between informal businesses and corporate South Africa?

#### **1.3.1 Sub-questions**

- What is the value of the informal sector in the development of informal settlement?
- What are the barriers hindering the formation of partnerships between corporate business and businesses operating in informal settlements?
- What has Corporate South Africa done to engage with informal settlements through partnerships?
- What is government's policy regarding the formation of linkages between these groups?
- What roles are Provincial and Local governments playing in facilitating the development of sustainable partnerships?
- Are there any countries that have experienced successfully formalized partnerships between informal businesses and corporations?
- How can the buzz partnerships play a role in planning for the creation of entrepreneurship or employment?
- How focus of planning intervention creates or engages both the informal and corporate South Africa in order to create sustainable partnerships?

These questions are refined to look at the jigsaw components of impediments in the formation of partnerships. They are focused on the role of institutions, policy, comparison and possible influence of planning. The relationship between formal and informal businesses within informal settlements is not the concern of this research. Also, the relationship between formal business and corporate South Africa is not central to this exploration. However, substantive issues around

these will be part of the discussion. The following section will present the methodology used for gathering and analyzing data.

#### **1.4 Research Approaches**

This first section will discuss the qualitative and descriptive design methods that are used in this study. In a qualitative analysis, data is gathered in the field by the researcher and one develops their own theories or understanding about what was observed. A researcher using qualitative methods “develops explanations or generalizations that are close to concrete data and contexts, but more than simple descriptions” (Neuman, 1997, p. 420). This method allows the researcher to understand how the subjects who are being researched understand their situation and their role in a particular context. The application of a qualitative approach ensures that the respondents’ opinions with regards to the effectiveness of the Municipality’s addressing of their challenges was key.

A descriptive research method was used for this study. A descriptive approach “presents a picture of types of people or of social activities” (Neuman, 1997, p. 20). With regard to this research, a picture of informal traders is provided. Qualitative researchers use this information because they are interested in “understanding the meaning people have constructed, that is how they make sense of their world” (Merriam, 1998, p. 1). A descriptive research study is appropriate, because the goals of descriptive research are in line with what I am interested to answer in this study. For example, in a descriptive research study, the results document information that contradicts prior beliefs” (Neuman, 1997, p. 20). In a descriptive study the researcher observes the situation or people and does not attempt to control the situation by intervening. In such a study the role of the researcher is to gather information as it stands and as Hopkins (2001) notes “no attempt is made to change behavior or conditions – you measure things as they are”. The pre-conceived ideas about the informal traders operating in informal settlements have underestimated their business management capacities and how that could be improved in order to foster sustainable links between informal and formal businesses. The research will also provide background information about the informal sector in South Africa, which is another characteristic of descriptive research.

### **1.4.1 Research Methods**

The research is based on interviews with informal traders in Diepsloot, an informal settlement in the Province of Gauteng. The research involved conducting in depth face to face interviews with twelve (12) informal traders. The researcher received permission from Mr. Blessing Sikhosana, a Community Development Worker in the local Municipality. Mr. Sikhosana was selected due to his detailed engagement with informal traders, addressing their challenges on an ongoing basis. Mr. Sikhosana chose the informal traders to be interviewed and accompanied the researcher to all the interviews. The researcher has personally administered the research questionnaires (open-ended and semi-structured) to the informal traders of Diepsloot through visits to their work place. This has facilitated in the provision of informal trader' perception on the possibility of future sustainable links with formal businesses, thereby achieving the research objectives. Furthermore, the researcher conducted in depth face-to-face interviews with Executive Directors of Group Five and Corobrick respectively to draw data from their company policy regarding their dealings with informal traders. An interview was the best option for obtaining an understanding of the informal sector in Diepsloot because it allowed the researcher to obtain a lot of information about the sector in the least amount of time, thus allowing for a more detailed comparison with the literature available. The interviews were conducted in September 2008.

### **1.4.2 Sampling Procedures**

As mentioned above, fourteen participants in all were chosen for the study, twelve from the informal sector, and two from the formal sector. All these respondents were identified as key for information needed for this research. The reason for having more respondents from the street trading informal sector was because they formed a larger proportion of the whole informal sector and their opinions as traders working in such close proximity with formal businesses were fundamental for this research. The study implemented was qualitative and therefore did not employ any statistical representation but rather sought information validity.

### **1.4.3 Methods of achieving reliable results**

When asking participants the questions on the questionnaire, I had to explain that answering questions was voluntary, that I was a student, and that their names will not be used. Meetings with a Councilor were used as an entry point to understand the best way to approach the participants and to gauge their understanding of the questions. In addition to the questionnaire other source of information were gathered to better understand the informal sector in South Africa and the other countries in the world, as well as government policies. These data collection strategies will be presented in the next section.

Both primary and secondary data were collected for the research report using various sources in the public domain such as library books and periodicals. Information not in the public domain such as interviews with traders and local municipality officials was also used. Once this information was collected, it was analysed. The following section will discuss how this analysis was conducted.

### **1.4.4 Data Analysis Strategies**

The Thematic method was used to analyse the data collected. This is a tool for data analysis often used for qualitative research (Aronson, 1994). It focuses on identifiable themes and patterns that emerge from conversation during interviews (ibid.). In this case the research questions were used as themes in order to ensure that the analysis explains the research findings and most importantly, achieves the objectives of the research. The use of themes in the presentation of findings and their analysis has also played a central role in managing the raw data. This method has also made it unproblematic to integrate relevant literature, empirical knowledge and theories which explain the findings of the study. Moreover the conclusions and recommendations were drawn from the analysed data. This means that there was a linear correlation between the research findings, analysis, conclusions and recommendations.



### **1.4.5 Limitations of the Research**

The research conducted with traders may have been constrained by the fact that results obtained during the interview process, interview with traders were largely negative about the local municipality. Also the informal traders were forthcoming with information and willing to express views more than the local council and formal businesses were. The challenge was to explain the perspective of traders and the relationship or lack there-off between them and the formal businesses in an effective way while at the same time not imposing my previously established views. Additional information taken from other sources about the situation, such as from studies done on the sector, was used to provide balance. Language posed a limitation in that with some traders an interpreter was used. In order to ensure that accurate information was obtained, the questions for the interview were as simple as possible.

In the next section a brief overview of the international literature on the informal sector will be presented.

### **1.5 Overview of International Experience on Informality and Partnerships**

This study will draw on diverse literature on the question of lack of partnerships between corporate South Africa and informal businesses operating in informal settlements. This literature does not deal directly with partnerships. But it is a rich source for providing explanations for the lack of partnerships through particular interpretive frames of textual analysis. The literature on partnerships tends to focus on governance issues and, in particular, the partnerships between formal businesses irrespective of size. This inclination can be explained in terms of the inherent biases towards the support of formal business as noted by Dewar and Watson (1991).

Firstly, the research looks at the concept of the informal sector, starting with the work of Hernando De Soto, the Peruvian Economist who writes from a Latin American experience. De Soto's central point is that the Third World poor tend to possess de facto control over surprisingly large amounts of assets, such as houses, land, and small businesses. Yet this section of society finds it difficult to use its possessions as collateral to borrow money to invest in starting small businesses. Also in Latin America I will look at the challenge posed by Janice

Perlman of the favelados. She argues that they are not separate from or on the margins of the system, but are tightly bound into it in a severely asymmetrical form. They contribute their hard work, their high hopes, and their loyalties, but do not benefit from the goods and services of the system. They are not economically and politically marginal, but are exploited, manipulated, and repressed; they are not socially and culturally marginal, but stigmatized and excluded from a closed class system. The above point is in line with De Soto's views on formality. Secondly, the research explores the ideas of Chen who writes from an Asian experience. She focuses on how to form links that add value to the informal sector between corporations and the former. She also addresses the issue of formalization. Also, in Asia the research will look at the works of Mitra (2002) who writes from a sub-continent perspective. Mitra argues on one hand that in India workers in the informal economy make significant contributions to the national economy. Therefore the focus should be on training. Waldron (1995) on the other hand looks at how in Malaysia the formal financial sector functions in parallel with the efficient and dynamic informal financial sector.

The research will then look at Africa starting with the work of Geoffrey Nwaka, a Professor at Abia State University in Uturu, Nigeria. Professor Nwaka argues that governments can support and regulate the urban informal sector in order to promote employment, productivity and income for the poor. He looks at how informal businesses in Nigeria have sustained the Nigerian economy. Nwaka is also concerned about ensuring a safe, healthy and socially acceptable environment for the informal sector. In South Africa, the primary focus is on Christian Rogerson and Caroline Skinner, who have both written extensively on informal businesses looking at them from a geographical perspective. Caroline Skinner on the one hand has written on challenges facing women traders. Rogerson on the other hand examines the key processes that are shaping the growing and evolving informal economy in South Africa with particular focus on Gauteng. Vanessa Watson and David Dewar look at urban planning and the informal sector. It is important to note that the South African informal sector received more and more attention from researchers during the last two decades. Examples of this attention include the works of Krige (1988), Nattrass (2000), and Barker (2003) as well as Muller (2003). The consensus in the South African literature is that employment in the informal sector offered a second best alternative to formal sector employment. Individuals, Africans in the majority of cases, unable to secure employment

in the formal sector were forced into informal means of employment in order to lead an existence of survival in one of a range of low income marginal informal sector activities (Muller, 2003). It is important to note that this literature is not exhaustive but the intention is to provide some reflections on the experiences of the different countries and South Africa.

The informal Sector was greatly popularized by De Soto (1989) in his book, *The Other Path: The Invisible Revolution in the Third World*. In this book De Soto makes an exhaustive study of the informal sector in Peru and the way in which informality helps the poor to transcend their state of impoverishment. He shuns the usual problem-oriented approach and does not stress the unregistered, illegal and negative aspects of this sector. Instead, he contends that informality is not a problem, but rather it should be seen as a solution to the problems that governments of various countries create through their inability to give rights to their impoverished communities. However, as much as he is engaging on the issue of the informal sector, De Soto (1989) does not draw the link between formal and informal business as a means of dealing with the challenge of poverty and the lack of policies to foster that relationship. His main argument is that once informal businesses are formalized they can access funds from formal businesses and that way grow their businesses. The most important point that De Soto misses is that informal businesses do not want to be formalized.

Royston (2005) challenges De Soto's (1989) views especially on "mythologies" arguing that they offer a simple yet beguiling message: capitalism can be made to work for the poor, through formalizing their property rights in houses, land and small businesses. This approach, it must be noted, resonates strongly in the South African context, where private property is dominant and works well for those who inhabit the so-called 'first economy'. The above point was also reiterated by President Mbeki (2003) who observes that South Africa is characterized by two parallel economies, the first and second. The first economy is modern, operating within advanced technology, integrated with the global economy and produces the bulk of the country's wealth. At the same time, international support for De Soto's ideas appears to be increasing. A High-level Commission on the Legal Empowerment of the Poor was launched, hosted by De Soto and the United Nations Development Programme (UNDP). This is rather problematic in that De Soto appears to favor promoting capitalism at the expense of the poor.

Royston also observes that this initiative is generating strong opposition from Non-Governmental-Organisations (NGOs), social movements and bodies such as the International Land Coalition, which contest the single-minded focus on individual title, formalisation and credit as solutions to poverty. Policy analyses from South Africa suggest that many of De Soto's policy prescriptions may be inappropriate for the poorest and most vulnerable in our society, and have negative rather than positive impacts on the security and well-being of the poor (Royston, 2005).

In South East Asia, Martha Chen in her article, "*Rethinking the Informal Economy: Linkages with the Formal Economy and the Formal Regulatory Environment*", explores the relationship of the informal economy with the formal economy and the formal regulatory environment. Chen argues that despite predictions of its eventual demise the informal economy has not only grown in many countries but also emerged in new guises and unexpected places. Secondly, she recognizes that despite continuing debates about its defining features, supporting informal enterprises and improving informal jobs are increasingly recognized as key pathways to promoting growth and reducing poverty.

Chen defines the key features of the informal economy as its significance and permanence, the continuum of employment relations within it and its segmented structure. These features have currency today. She points out that few informal enterprises, except perhaps some survival activities, operate in total isolation from formal firms. Most source raw materials from and or supply finished goods to formal firms either directly or through intermediate (often informal) firms. Sourcing and supplying of goods or services can take place through individual transactions but are more likely to take place through a sub-sector network of commercial relationships or a value chain of sub-contracted relationships.

Chen (2007) argues that a key issue in the debates on the informal economy is whether and how the informal economy and formal economy are linked. However, these debates have tended to blur the distinction between the formal economy and the formal regulatory environment as well as the relationship between informal enterprises and informal workers. It is important to distinguish between firstly, the *formal economy*, comprising regulated economic units and protected workers; and secondly, the *formal regulatory environment* comprising government policies, laws, and regulations. Dewar and Watson (1991) however, challenges Chen's above

point noting that the debate stems from a recognition of the numerous and complex linkages between the formal and informal sectors. It hinges on two questions: first, whether the linkages are of a benign or exploitative nature; and second, whether the lower end of the economic continuum is capable of responding to promotional policies or not. Tokman (1978) asks whether it is evolutionary or if it is involutionary? Tokman points out that evolutionary pole comprises activities marked by rising labour productivity resulting, at the level of production conditions, from an increase in capital outlay, and, at the level of market conditions, from a widening of the scale of activity. The involutionary pole is characterized by a regression of labour productivity at the level of production conditions and a reduction of scale at the level of the market. When household employees replace domestic appliances that are too expensive, or trolley-pushers replace taxis for small loads, or when petty traders create divisibility by selling cigarettes by the stick or piles of vegetables, there is a fall in labour productivity and the development of involutionary activities.

Rogerson (1991) writing on one South African context, draws attention to the possibility of fostering closer linkages between large and small enterprises as a means of supporting the development of informal enterprise, especially growth businesses. Rogerson (1992) points out that in formulating policy frameworks policy makers should recognise that the informal economy is of a highly diverse nature and in a state of constant change. Rogerson's argument for competitive growth is in direct contrast with Thomas's position on the informal sector. He sees the informal sector as providing poverty relief for the poor as illustrated below. Thomas (1993) by suggesting that in general, most assistance to survivalist enterprises should be considered as a form of poverty relief or welfare support. The challenge to the formulation of policy on those trapped in the survival sector is "to at least achieve a minimum income and meet a certain quality of life standards" (Thomas, 1993, p. 20). However, it must be noted that Thomas's focus on formulation of policy by government, undermines the potential growth of the informal sector. He does not see the formal sector as playing a role in assisting with the growth of the informal sector. He continues that once the economy picks up, formal and viable informal enterprise should expand, or start anew, resulting in a gradual decline of the magnitude of mere survivors (Thomas, 1993, p. 20). Rogerson (1991) on the other hand, believes that indiscriminate promotion of informal economies "will be accompanied by an expansion of arduous, poorly

paid, unstable and precarious working conditions.” He believes that the state should back those enterprises which are competitive and which have growth potential. Both Rogerson (1991) and Thomas (1992) do not view this challenge as a concern that corporate South Africa should engage.

Historically speaking, co-operation between formal and informal businesses in South Africa has not developed to a meaningful extent. Manning (1993) observes that big business lacks a culture of co-operating with small firms and most corporate responsibility for informal development remains at the level of rhetoric. Horn (1994) suggest that the major problem inhibiting the establishment and running of informal businesses is access to loans for the purchase of equipment and financing inventories. Nattrass (1990) in comparing Europe, Japan and South Africa, comments that unlike developments in parts of Japan, Germany, or Italy, an extensive network of subcontracting between large and small enterprises in order to facilitate the latter’s development in a mutually symbiotic relationship has never evolved in South Africa. Instead, a pattern has emerged in which the highly concentrated structure of the South African economy has encouraged large enterprises to deal mainly with one another.

The Japanese National Commission for UNESCO (1987) points out that the small business form of enterprise is a predominant part of the Japanese economy. They argue that this is chiefly due to the fact that capitalism was introduced to Japan much later compared to Western countries. To catch up with the western world, the Japanese government gave preferential treatment to key industries and as a result, some enterprises relatively few in number, developed into giant businesses or industrial corporations through the adoption of modern management techniques. The Japanese model clearly shows how thriving informal businesses can be turned into viable businesses with the help of formal businesses and government intervention through policy formulation that encourages partnerships between formal and informal. Sunter (1987) observe that the experience of Japan and other Pacific Rim nations is applauded by many South African observers as a model for closer co-operation between large and small enterprises through a system of subcontracting. They view the expansion of business linkages through subcontracting particularly as a means of boosting the underdeveloped informal sector.

Nwaka (2000) writing from a Nigerian experience focuses on the main policy challenge of how to support and regulate the urban informal sector in order to promote employment, productivity, and reasonable income for the poor. Nwaka (2000) is also concerned about ensuring a safe, healthy and socially acceptable environment for the informal sector. Informal sector enterprises, especially those located in residential areas, pose real health hazards for the urban community, particularly for the urban poor who can least afford the high cost of health care. The policy dilemma appears to be how to contain the adverse environmental impacts of many of the activities of the urban informal sector without disrupting livelihoods, and causing social distress; how to promote environmental awareness and guarantee the right to the city, while at the same time protecting the vulnerable groups in the informal sector especially women, children, and apprentices from harm and exploitation.

The businesses that comprise the informal sector, typically operating on streets and in other public places, are often seen as eye-sores and undesirable activities. Thus, conflicts arise between urban authorities trying to keep their cities clean and the urban informal sector operators who need space for their activities. Peirera and Amin (1993) argue that environmental problems associated with the informal sector are mostly manifestations of unresponsive physical planning systems rather than attributes inherent to the sector's respective activities. An environmental impact analysis shows that provision of proper business premises to informal enterprises is an effective measure to curb the environmental problems associated with the sector. From this viewpoint, accommodating the informal sector in the urban built-environment is seen as an effective strategy for urban environmental management.

## **1.6 Conclusion**

The international literature on the informal sector uses a wide variety of definitions of the informal sector. Unfortunately, most of these definitions are study specific and therefore not applicable to other work. The formal definitions are useful when compiling official statistics such as the National Income Accounts but are of little use when it comes to research that needs to recognize the heterogeneous nature of the informal economy and lack of sustainable partnership with the formal sector. The role of the informal sector and the problems of lack of partnerships in South Africa clearly support the view that any effective strategies for

development have to develop and implement policies that aim at enhancing the socio economic environment of the informal sector.

When it comes to the reasons why people operate in the informal economy it may be concluded that there are a number of costs and benefits to doing so. The benefits largely revolve around the evasion of the regulatory environment within the formal economy. Some of the regulations include regulatory laws, licenses, and taxes. It is important to note that some believe that the greater the degree of regulation, the greater is the benefit of operating in the informal economy.



## **CHAPTER TWO: LITERATURE REVIEW**

### **2.1 Introduction**

Economic theorists differ on their views of how the informal economy came into being, what functions it serves and who participates in it. In this section, several of these major theories and perspectives are discussed. This chapter discusses the theories and perspectives found in the literature. This chapter begins with a brief overview of the experiences of the informal economies in developing and developed countries, starting with Latin America followed by North America, Asia, and finally Africa. Then the chapter moves on to discuss theories of the informal economy as a safety net for the poor versus an additional economic opportunity for those already employed in the formal sector. Lastly the chapter looks at theories regarding the connection between formal and informal sectors.

The term ‘informal’ was coined by Keith Hart (1973) in his article on informal income opportunities in Ghana, whereas the 1972 International Labour Office report on employment and poverty in Kenya was the starting point of the subsequent notoriety of the ‘informal sector’ as observed by (Sindzingre, 2005). What gave rise to these terms was mainly that new entrants to the urban labor force seemed to have created their own employment individually or worked in small-scale family businesses. These individual workers and businesses consisted of a large group of small-scale economic activities that were and still are usually ignored by the formal sector. Many of those engaged in such businesses were successful small-scale family run enterprises with several employees who were usually relatives of the family. Some of them were eventually successful enough to enter the formal modern sector. As such, it was gradually recognized that the informal sector plays a crucial role in developing economies, as it absorbs the large additions to the labor force that the formal sector is not able to accommodate, as well as acting as a source of livelihood for lower-income earners living in rural and township areas who would otherwise have no source of income.

Before presenting the broad and current information available about the informal sector, it is important to first provide an understanding of the sector. The next section will outline the nature of the sector.

## 2.2 The Nature of the Sector

Skinner (2004), in a speech at the Department of Trade and Industry meeting held in Pretoria, South Africa, expressed a view that the formal and informal economies are not separate sectors, but rather two components of the same economy. Strikingly noticeable here is the concept of dualism, which is a popular term used in development economics to describe a situation in which the “superior and inferior can exist in the same space” (Coetzee, Graaf, Hendricks, Woods, 2001, pp.83-84). The superior can be described as the wealthy, whereas the inferior are generally thought to be the poor and uneducated. The dualistic concept of development embraces the knowledge that the rich do little to help the underclass and actually “develop its underdevelopment” (Coetzee, Graaf, Hendricks, Woods, 2001, pp.83-84). Skinner (2006) points out that in August 2003, President Mbeki introduced the idea of South Africa as characterised by a ‘first economy’ and a ‘second economy’ operating side by side. In November, in an address to the National Council of Provinces he stated:

*“The second economy (or the marginalised economy) is characterised by underdevelopment, contributes little to GDP ,contains a big percentage of our population, incorporates the poorest of our rural and urban poor, is structurally disconnected from both the first and the global economy and is incapable of self generated growth and development.”*

Skinner et al (2006) argue that the conceptualisation and articulation of the first and second economy of South Africa by the Presidency coincided with a refocusing of economic policy in South Africa. This conceptualisation tacitly acknowledges the failure of the trickle down economic growth policies so central to the post-1996 GEAR era and informs much of government’s more recent emphasis on poverty alleviation. Skinner et al cites Naidoo (2004) who observes that the dualism suggested by arguments about a ‘structural’ break between the first and second economy, allow government to argue that its economic policies have been successful for the first economy and, as a result of these successes, government is now able to address issues of poverty and unemployment in the second economy. However, without the right policies government will never be able to successfully address the challenges faced by those in the informal economy.

De Soto attempts to answer the above concern by stating that the analysis of the economies of developing countries can no longer ignore the contribution of the informal sector. In his book *The Other Path* he examines the issue of informality in a highly original way and comes to conclusions that have direct importance for developing countries generally and for South Africa in particular. De Soto (1989) made an exhaustive study of the informal sector in Peru and the way in which informality helps the poor transcend their state of impoverishment. He contends that informality is not a problem, rather, it should be seen as a solution to the problems that governments of various countries create by their inability to give rights to their impoverished communities. De Soto (1989, p. 59) is of the opinion that “When legality is a privilege available only to those with political and economic power, those excluded, the poor have no alternative but illegality”

De Soto (1989) was clear from the outset that he was not prepared to accept that the circumstances of the poor could be understood without undertaking empirical studies. He aimed to gain a picture of informality based on the actual experience of the poor. The research took place against a background of large scale migration from the outlying rural areas to Lima, the capital city of Peru. Over the past 40 years, successive groups of new immigrants found that they had no access to formal housing and employment. They also found themselves prevented from legitimately starting a business because they could not meet the many legal requirements to do so. Under these systems, the people developed the system of extra-legal norms. They created their own economic and alternative legal order. Informality, as his research showed, came about as a way of overcoming debilitating existing legal restrictions and not as an anti-social activity.

De Soto (1989) discusses the development of three informal activities namely housing, trading and transport in detail and describes the ways in which Peruvian legislation hampers the development of the informal sector. He argues that there are two root causes of underdevelopment in Peru namely bad laws which govern formal activities, and the absence of good laws which encourage the development of informality. Both aspects impose heavy costs on Peruvian society. He points out that even though the costs of formality are heavy, the costs of informality are even more punitive. The informal operator has to remain hidden, relatively few workers can be employed in the business without it becoming detected and the scale of operation

is forced to remain small. This basically means that inefficient methods of production are used, there is a limit to the type of goods that can be made, products cannot be openly advertised and certain markets are out of reach of the informal business owner.

De Soto (1989) goes further in his explication of the informal sector, pointing out that the lack of recognition of informal business owners means that partnerships taking place between formal and informal business owners are often disadvantageous to the informal business owner. Therefore, De Soto argues that illegals need 'good' laws to give them rights. Property rights, contracts, and an extra contractual legal system applicable to informals are urgently needed. The excessively high cost of access to formality and of remaining formal put Peru's 'good' laws beyond the reach of informals. He continues that if laws that promote the functioning of the informal sector are introduced, this sector can thrive. But laws should be based on existing reality. Laws should not, according to De Soto try to shape reality.

De Soto (1989) however, fails to draw the link between informal and formal. He emphasizes the importance of legalization and ownership of property as primary issues overriding all else. What is key, however, is to understand the informality and the reasons why people choose it over all else. The challenge for most informal businesses is not to be legalized but to find ways to grow their businesses in order to be sustainable and viable businesses on their own. The major concern for most informal businesses is that Government policy for the second economy is either absent, and where it does exist, is piecemeal and ineffective. The next section will look at the similarities between developed and developing countries.

### **2.3 Parallel between the Developed and Developing Countries**

Hart (2005) argues that there is considerable overlap between his analysis and that of Hernando De Soto in *The Other Path* (1989) and *The Mystery of Capital* (2000). In the first, De Soto argued that Peru was a mercantilist state whose over-regulated and impenetrable national bureaucracy served the economic interests of a narrow clique and excluded the vast majority from effective participation in development. The latter was an entrepreneurial peasantry flocking in ever-larger numbers to the main cities. They were forced to operate informally, that is, outside the law in sectors such as housing, trade and transport.

Peru's tradition was inherited from the Spanish empire period and the term 'mercantilism' has been used to describe European political economy from the sixteenth to eighteenth centuries (Vaggi and Groenewegen 2003). It was succeeded, owing largely to Britain, by a free-trade regime more conducive to industrial capitalism. Peru's development in the twentieth century was parallel to that of the west earlier. A massive migration to the towns led to the legal exclusion of the poor by mercantilist bureaucracy, but the 'informals' won in the end by cheapening production, making the regulations irrelevant and from time to time erupting in violence. Peru was thus headed for a revolution along French or Russian lines unless the national bureaucracy simplified, decentralized and deregulated itself. In *The Mystery of Capital* (2000) Peru and other poor countries at the turn of the millennium are viewed as trapped in a world economy dominated by the first industrial nations. However, the crucial observation to make here is that De Soto (2000) does not comment on the partnerships that can be forged between informal and formal businesses so as to grow and develop informal businesses.

Red tape is mainly an effect of a global regime that forces marginal states to adopt inappropriate institutional practices. The result is the same, migrants piling up in cities and forced to work outside the law. De Soto (2000) claims that there is no shortage of wealth in the nonwestern world. What is missing is a property regime that would enable the masses to realize their wealth as investment capital. The banking sector is dominated by foreign firms and it runs along lines now standard in the rich countries. Informal property rights cannot be converted into collateral for loans. This is particularly unfair since countries like the United States of America (USA), which dominates this global financial bureaucracy and the institutions that supervise world trade and investment, made the transition to modern capitalism by allowing flexible informal practices full rein in their own development. It follows that similar flexibility has to be shown today if the poor urban masses are to have a chance of joining global development on less unequal terms. He suggests that "the alternative is more recruits to terrorist networks and large social explosions before long" (Ibid, p. 45).

Graner (2007) agrees with Royston in pointing out that De Soto's formalisation of the economy aims to protect rights of ownership and ease the way for free market transactions, not to create regulations and a social safety net. He points out that such regulations require that property rights

be formalised specifically in favour of private ownership; the same effects can be achieved in cooperative or public regimes. Above all, the regulations require a welfare-oriented political will and strength in which a formalization of economic relations makes up a perhaps important but far from sufficient foundation. In countries where politics, justice, and the monopoly of violence have traditionally been controlled by economic elite, there are also good reasons for weak groups to keep their meager assets out of the reach of public control (Graner 2007). He continues that there is no unambiguous empirical support for the idea that the formal economic sector is more effective than the informal. On the contrary, a number of studies indicate that productivity is in fact higher in the informal sector, probably because labour is exploited more harshly and bureaucracy plays a smaller role (Bigsten et al 2000). Graner (2007) illustrates his point by giving an example of Taiwan, often put forward as the most dynamic of the East Asian “tiger” economies yet a significant part of the industrial sector is primarily informally organized. Smets (2003) points out that for instance, when people living in slums apply for credit their lack of contacts, education, and language skills as well as the lack of documented and regular income often stands in their way even if property with formal titles can be used as security. Research on credit in developing countries shows that lenders often demand securities valued several times higher than the sum of the loan. This transformation would imply a significant decrease in the value De Soto (2000) estimates for dead capital (Woodruff 2001). Nor can we take for granted the fact that people who get access to more credit use it only for long term income producing investments.

Grainer (2007) in his critique of De Soto points out that in the latter’s rhetorical construction, the informal character of the economies becomes not only an explanation of why people live in poverty. Informal economy emerges more or less as synonymous with poverty. If the economic life of the poor could be incorporated into the rationally organized formal economy, their living conditions would improve rapidly. Poverty does not actually arise from a lack of resources, but a lack of proof of ownership. In this way, the organization of property rights becomes the only relevant distinction between formal and informal. All other components are ignored or treated as nothing more than secondary effects.

## 2.4 The Concept of Marginality

Janice Perlman (2002) writing from a Brazilian experience comments in her book *The Myth of Marginality* that the concept of marginality has been debunked, deconstructed, dismissed, and then rediscovered and reconstructed over the past decades. Perlman (1976) argued that the *favelados* are not marginal, but inexorably integrated into society, albeit in a manner detrimental to their own interests. They are not separate from or on the margins of the system, but are tightly bound into it in a severely asymmetrical form. They contribute their hard work, their high hopes, and their loyalties, but do not benefit from the goods and services of the system. They are not economically and politically marginal, but are exploited, manipulated, and repressed; they are not socially and culturally marginal, but stigmatized and excluded from a closed class system.

Perlman (2002) further argues that in the modernization literature migrants from the countryside to the city were seen as maladapted to modern city life and, therefore, responsible for their own poverty and their failure to be absorbed into formal job and housing markets. Squatter settlements were seen as “syphilitic sores on the beautiful body of the city,” dens of crime, violence, prostitution, and social breakdown. It was widely assumed in some circles, that comparing their condition with the surrounding opulence would turn squatters into angry revolutionaries. Such was the fear of the Right and the hope of the Left. The view of squatters as “other,” not part of the urban community, was the common sense view of the population at large, legitimized by social scientists, and used to justify public policies of *favela* removal. Marginality was a material force as well as an ideological concept and a description of social reality. This continues to be the case today. It is interesting to note that governments of developing countries fail to draw the link between formal and informal businesses as a way of human development.

Perlman (2002) illustrates clearly the similarities between South Africa and Brazil in that when the African National Congress (ANC) came into power it had grand policies that were meant to benefit the marginalized blacks. The Reconstruction and Redistribution Programme (RDP) was a noble concept to deal with the injustices of the past that marginalized millions of blacks. However, these policies appeared to be too socialist in nature for the international aid agencies and were discarded in favour of neo-liberal policies.

Marais (1998), Hart and Padayachee (2000) echo the observation just made, that even before the African National Congress (ANC) took power, they had formulated an economic policy that would harness the energies of the black majority. It was called the Reconstruction and Development Programme (RDP). Redistribution from the white beneficiaries of apartheid could never meet the needs of 30 million poor Africans for income, jobs, education, health, housing, transport, etc. The only solution was for the government to act as a source of capital and coordination for decentralised development mobilising what the country had in abundance labour to be deployed by local communities in self-help projects. Two years after gaining power, the ANC replaced the RDP with a new programme, Growth Employment and Redistribution (GEAR). Instead of helping communities build their own houses, the government relied on foreign loans, imported materials and development bureaucracy (Nustad 2004). South Africa, which began with so much political goodwill, joined the neo-liberal world economy with escalating economic inequality the inevitable result.

Mobilising communities for self-help is commendable, but in practice it was incompatible with running a strong centralised state and the ANC entered government with a firm ideological commitment to such a state. The central bureaucracy found that it could not control devolved projects at the periphery. Even worse, the ANC was often empowering its political opponents. Bottom-up development was not compatible with party rule. The government's economic policy, GEAR, recognized that if the government could not enter partnership directly with the people, it would have to rely more heavily on international agencies and capital. In this way South Africa repeated the continent's post-colonial pattern towards dependence on outsiders (Hart, 2001).

Perlman (2005) however, points to how Luiz Inácio 'Lula' da Silva, who was elected in 2002, has been considerably challenged in confronting urban poverty and unemployment. In the face of international financial institution stipulations namely debt obligations and maintenance of a 4.25% fiscal surplus, da Silva has had little room to maneuver in the social arena. This has resulted in the people in the *favelas* (and the poor in general) feeling betrayed by one of their own. Instead of more jobs and increased social spending on job-creation and job readiness programs, da Silva opted to toe the conservative free-market International Monetary Fund (IMF)



line, putting him in a challenging position to live up to hopes created by his personal history and political campaign. He has ended up cobbling together social programs put in place by his predecessor, Fernando Henrique Cardoso, and making matters worse by taking an extremely partisan rather than professional approach to his political appointments, and tolerating blatant graft and corruption in his government (Bearak 2004). The same could be said of South Africa where the government adopted neo-liberal policies that grew the economy and only a few elite groups profited from that. The rest of the African majority was left out of that growth and the informal sector they operate in was neglected. There is no policy that addresses the lack of partnerships between formal and informal businesses in South Africa.

This then brings us full circle to the discourse on the forms and consequences of economic marginality. How can a country or a city thrive while rendering irrelevant a quarter or even a third of its population? What does this represent in loss of potential intellectual capital? Lost productive capacity? Reduced consumer power? Reduced cultural contribution? What does it bode for a fragile democracy needing all the help it can get, and for the values and behaviors being transmitted to the next generation? (Perlman 2005). This is where Amartya Sen's (1999, p.17) discussion of poverty as "capability deprivation" and not simply low income becomes helpful. Sen (1999) deems capacity deprivations as "intrinsically significant," as opposed to low income, which may be a temporary condition, or may be only of instrumental importance for attaining some other goal. The deprivation concept, as it takes into consideration various influences and circumstances other than low incomes, can result in a condition of poverty.

As a recent Brazilian government report puts it, "the informal economy . . . undermines the evaluation of credit risk by banks, raises the cost of borrowing and curtails the use of capital market instruments, where transparency is a necessary condition for efficiency" (Rocca: 2004, p. 24). Of the 6,000 or so Brazilian companies with more than 250 workers, only 120 are listed and regularly traded on the São Paulo stock exchange. The effects of informality on firm behavior emerge very clearly from the results of the World Bank's Investment Climate Survey in Brazil (2003). This survey covered more than 1,600 firms in a broad range of manufacturing activities. Because obtaining direct information about tax evasion is almost impossible (respondents are usually unwilling to acknowledge it), the survey asked firms what fraction of sales "a typical

establishment in their area of activity” would report for tax purposes. This indicator serves as a proxy for a firm’s own level of compliance. The next section will look at the informal sector in America.

## **2.5 American Informal Economy**

It is important to note the vast difference between the economies of the North and Latin America. The difference could be attributed to colonialism where elite groups were afforded privileges based on the color of their skin and other factors. In Latin America informality of every kind, what Perlman refers to as marginality, is accepted. In North America it is a new phenomenon. Sussen (1988) in her article *New York City’s Informal Economy*, presents a small but growing body of evidence that points to the expansion of informal sectors in major cities of the U.S. over the last decade (Fernandez Kelly, 1984; Stepick, 1984; Sassen-Koob, 1985). These studies focus on the production and sale of goods and services that are licit, but produced and or sold outside the regulatory apparatus covering zoning, tax, health and safety, minimum wage laws, and other types of standards. The evidence these studies are presenting runs counter to prevailing conceptions of the informal sector as well as of the nature of highly industrialized economies.

While criminal activities and under reporting of income are generally recognized in advanced industrialized economies, informal sectors are not. The literature on the informal sector has mostly focused on Third World countries and has, wittingly or not, assumed that as a social type such sectors are not to be expected in advanced industrialized countries. The literature on industrialisation has assumed that as development progresses, so will the standardisation of production and generalisation of the formal organisation of work. Because the informal sector in the United States (U.S.) is perhaps most evident in immigrant communities, there has been a tendency to explain its expansion as a consequence of the large influx of Third World immigrants and their propensities to replicate survival strategies typical of home countries. Not unrelated is the notion that the availability of a large supply of cheap immigrant workers facilitates the survival of backward sectors of the economy.

A central question for theory and policy is whether the formation and expansion of informal sectors in advanced industrialised countries is the result of conditions created by advanced capitalism. Rather than assume that Third World immigration is causing informalisation, we need a critical examination of the role it may or may not play in this process. Immigrants, in so far as they tend to form communities, may be in a favorable position to seize the opportunities represented by informalisation. But the opportunities are not necessarily created by immigrants. They may well be a structured outcome of current trends in the advanced industrialised economies. Similarly, what are perceived as backward sectors of the economy may or may not be remnants from an earlier phase of industrialisation. They may well represent a downgrading of work involving growing sectors of the economy (Sussen, 1988).

## **2.6 Asian Informal Economy**

Waldron (1995) argues that one of the primary reasons East Asia has been able to fuel economic growth is that profits from the informal sector have provided essential capital to the formal sector since the 1960s. Within East Asia, functioning parallel to the formal financial sector is an efficient and dynamic informal financial sector. This sector is multidimensional and has a positive effect on the regional economy. Malaysia is often cited as a success story in terms of how the formal banking institutions have contributed to improving the sector by investing in its future. It is often non-governmental organizations (NGOs) that provide financial services to the poor and low income earners in Malaysia. NGO's rely largely on donor support to provide loans. Jayasooria and Kasim (2001) however, point out that the problem with the NGOs is that they do not charge the appropriate amounts for the financial services provided. This hinders their ability to be self-sustaining.

In India, the focus is on training in the context of an economy characterised by the sheer magnitude of the informal sector, and draws some lessons on how training interventions should be designed to create a suitable learning environment that supports an effective use and absorption of skills by informal workers, whether as individuals or as members of communities.

Mitra (2002) notes that in India the training is often equated with technical training or education, geared towards the formal sector. There is a strong urban bias, a very marked gender division of training and curricula, and the training system is highly centralised. The upper castes and classes benefit most from the system as very often the lower castes and classes experience strong economic or other barriers to entry into some of the courses. In Latin America, De Soto (1989, p. 59) also noted that “when legality is a privilege available only to those with political and economic power, those excluded, the poor have no alternative but illegality.” The difference however between some countries in Latin America and India is that those with political and economic power in India access the informal sector for their benefit at the expense of those who are from low casts and class. But it is also noted that much of the training provided by the formal training institutions is for skills which are not much in demand. Curricula have not been revised for many years and are therefore not attuned to current market requirements. Some revision has taken place recently, but a lot remains to be done. Mitra (2002) observes that one reason for the lack of attention to market requirements is the lack of involvement by the industry in the management of the training institutions.

Since empowerment is one of the components of decent work, education and training should aim not only at employment, but also at the empowerment of informal workers. Therefore training or skill-building in the informal sector needs to be seen as an enabling tool. Mitra (2002) further notes that this means that along with technical or vocational skills (which need to be updated continuously) other important capacities such as social and negotiation skills, as well as the basic knowledge required to survive in an increasingly competitive world need to be built up. The next section will focus on the relationship or lack thereof between the informal sector, formal sector and the formal regulatory environment.

## **2.7 Linkages with the Formal Economy and the Formal Regulatory Environment**

Chen (2000) in her article “Rethinking the Informal Economy: Linkages with the Formal Economy and the Formal Regulatory Environment,” explores the relationship between the informal economy, the formal economy and the formal regulatory environment. Chen (2005) concurs with De Soto to some degree and expands the debate to look at how despite predictions of its eventual demise, the informal economy has not only grown in many countries but also

emerged in new guises and unexpected places. Despite continuing debates about its defining features, supporting informal enterprises and improving informal jobs are increasingly recognized as key pathways to promoting growth and reducing poverty.

Although De Soto's argument was relevant in the 1980's, Chen (2005) has expanded it, making it relevant to what is happening currently. Chen argues that over the years the debates on the informal economy crystallized into three dominant schools of thought regarding the informal economy: dualism, structuralism and legalism. Each of these has a different perspective on how the informal and formal economies are linked. She points out that the dualists argue that informal units and activities have few (if any) linkages to the formal economy but, rather, operate as a distinct separate sector of the economy, and that informal workers comprise the less-advantaged sector of a dualistic labor market (Sethuraman, 1976; Tokman, 1978).

Unlike the dualists, structuralists see the informal and formal economies as intrinsically linked. To increase competitiveness, capitalist firms in the formal economy are seen to reduce their input costs, including labor costs, by promoting informal production and employment relationships with subordinated economic units and workers. According to structuralists, both informal enterprises and informal wage workers are subordinated to the interests of capitalist development, providing cheap goods and services (Moser, 1978; Portes et al., 1989). The legalists focus on the relationship between informal entrepreneurs/enterprises and the formal regulatory environment, not formal firms. But they acknowledge that capitalist interests – what De Soto calls 'mercantilist' interests – collude with government to set the bureaucratic 'rules of the game' (De Soto, 1989).

In South Africa Skinner *et al* (2006) elaborate on the above point by illustrating that a particular problem in policy terms for those working in the informal economy is the idea of the second economy being 'structurally disconnected from the first'. Case study evidence indicates that there are multiple forward and backward linkages between formal and informal activities. For example, Skinner cites Ince's (2003) work on informal clothing manufacturing in a residential area in Durban which demonstrated that not only do manufacturers source their inputs in the formal economy, but the garments often end up in formal retail stores. Witt's (2000) work on

informal fruit and vegetable distribution demonstrates multiple linkages. It is these linkages which, in policy terms, are often the most interesting areas to concentrate on.

Given the heterogeneity of the informal economy, there is some truth to each of these perspectives. But the reality of informal employment is more complex than these perspectives would suggest. What follows is a summary of various ways in which informal enterprises are linked to formal firms. Few informal enterprises, except perhaps some survival activities, operate in total isolation from formal firms. Most source raw materials from and or supply finished goods to formal firms either directly or through intermediate (often informal) firms. Sourcing and supplying of goods or services can take place through *individual transactions* but are more likely to take place through a *sub-sector network* of commercial relationships or a *value chain* of sub-contracted relationships (Chen, 2006).

## **2.8 The Informal Sector and the Macro-economy**

Haan (1999) argues that the Growth and Equity through Micro-enterprise Investments and Institutions (GEMINI) studies offer an interesting impression of the intricate relationship that informal Medium, Small, Enterprises (MSE) have with the rest of the economy. It was found that when the economy is growing well, MSEs also thrive, expanding by engaging additional workers - while other entrepreneurs are closing their firms to move to more rewarding activities. When the economy is stagnating, MSEs face hard times and only a few of them are expanding, while others will even lay off workers. At the same time, there is also increased pressure for new labour market entrants who cannot find a wage job to start new businesses, even if these yield only marginal returns. Kenya presents a good example of this “churning”.

Haan (1999) states that in 1994, employment in MSEs grew by nearly 100,000 as the net result of 250,000 people starting work in such activities (227,000 in new enterprises and 27,000 taken on in existing businesses), a number partially offset by 157,000 people who stopped working when their firms closed. In other words, in 1994 when GDP hardly expanded, about 70 per cent of the net new jobs came into existence as a result of net starts, with only 30 per cent coming from expansions. In the next year, 1995, when the rains were good and the business climate improved, these figures were reversed: only about 30 per cent came from net starts, while close

to 70 per cent came from an expansion of new enterprises. It was also found that in those enterprises that expanded their employment, which are probably more towards the top end of the informal sector, the incomes earned were more than twice the level in those enterprises that were newly established. “Expansion jobs” appear to be substantially more productive, compared to those that result from new business starts, which are more probably at the bottom end of the informal sector. The number of new informal establishments is so large that it is impossible to provide adequate services to all of them. Since the sector is diverse and heterogeneous, it includes various target groups all with different potential contributions to the economy and different sets of support needs. The analysis based on the results of the surveys also appears to suggest, for instance, that it would be wise to focus interventions on MSEs that have survived the first two years and are likely to grow (Haan ,1999).

Liedholm and Mead (1987) suggest that different categories of MSEs can make different contributions to the dual objectives of poverty alleviation and economic growth. “*Survival activities*”, which include many new and very small micro enterprises that do not expand in terms of employment, are particularly appropriate target groups for poverty alleviation and can be extremely important in helping a large number of very poor people become a little less poor. Programmes could increase the likelihood that these micro enterprises can survive and can earn somewhat higher and more reliable levels of income, particularly by providing a small amount of a single missing ingredient – working capital, which is all that is required to sustain the enterprise and to enable it to improve its performance. It seems likely that helping more of these enterprises survive can make a greater contribution to MSE employment and incomes than equal efforts aimed at the promotion of new starts. The next section will look at training in the informal sector.

## **2.9 Informal Sector and Training**

Nanyangwe et al (2004) point to an institution in Zambia that was set up to promote the informal sector, the Association of CISEP Users (ACU), consisting of institutions that apply the Concept for Informal Sector Employment Promotion (CISEP). Originally, this institution was designed to provide training for informal sector operators (ISOs) to upgrade their practical and business

management skills and competences. It has been recognized, though, that training by itself is not sufficient to increase the productivity of the small units. The ISOs are facing constraints that are insurmountable as “one-man shows”. ACU, in an attempt to discover new strategies to promote the ISOs called for a study to determine the forms of cooperation among ISOs present in Zambia’s informal sector. These structures could then be used to build up on and to increase the cooperation in order to enhance the performance of the informal sector and to bring about increases in productivity. Though they are difficult to measure, increases in productivity, at a certain point, could contribute to a transition from an informal to a formal enterprise. This in turn should affect the government’s tax base positively and an increased tax base could improve the government’s capability to provide essential public services such as health services in the face of the Aids pandemic as well as educational services or the maintenance of infrastructure. The informal sector might therefore play a crucial role in the long-term development of Zambia.

The emphasis in Zambia is not on regulating the informal sector, however. It is to find ways to develop and to grow the informal sector. The trend in Africa generally is to consider the informal sector as a means of fighting poverty and at the same time creating sustainable businesses. Governments work closely with international development agencies to find solutions for this industry.

Nwaka (2000) on the one hand agrees with both De Soto and Chen on the fact that the main policy challenge is on how to support and regulate the urban informal sector in order to promote employment, productivity, and income for the poor, and at the same time ensure a safe, healthy and socially acceptable environment. Fapohunda (1985) on the other hand is concerned with the problems besetting the informal sector especially in Nigeria. He points out that the informal sector has problems ranging from lack of capital and space, irregular supply of electric power to persecution even by the government. He argues that the informal sector is the training ground for many workers, and could be a source of growth of the economy if properly guided and managed. He points out a number of problems facing the industry:

- The first problem is to get the business started. He argues that for the businesses now in operation the most important difficulties they had in establishing themselves were capital and accommodation to house their enterprises.



- Location could be very important for the successful operation of a business not only because the business might need a large area of land to operate but also because certain locations are better than others in terms of proximity to the sources of raw materials and to markets.
- Apart from non availability of capital and lack of space, technological competence was a problem to some firms when they were starting their businesses.

Fapohunda (1985) observes that informal sector enterprises usually operate without government licences. This ensures ease of entry into the business as there are no legal restrictions imposed by the government. Informal businesses usually operate without government inspection. Fapohunda (1985) continues that lack of regulation or inspection of informal sector enterprises means that it would be difficult to have a product quality control scheme or maintain any standard. He argues that the advantages of a limited liability companies are always a source of huge revenues to the government. Government requires all companies to pay taxes on their profits at the rate of forty-five per cent. But informal sector enterprises rarely pay taxes. In Nigeria, Fapohunda (1985) points out that, only 26,1 per cent, that is, about a quarter of the informal sector enterprises pay taxes or pay any fees to operate.

## **2.10 Linkages between Informal and Formal Sector in South Africa**

According to Xaba (2002) there are a few studies that have attempted to understand the extent to which the informal economy is integrated into the national economy, particularly its relationship to the formal economy. There are forward linkages (to markets beyond the borders of the informal economy) and backward linkages (in the form of inputs from outside the informal economy). A study done by May and Stavrou (1989) found that in South Africa, the formal economy depends on the informal economy to act as a source of goods and services and to provide a market for its own produce.

However, Meagher (1995) argues that in third world countries, the linkages between informal and formal economy have led to informalisation of work in the formal economy as a means to enhance the profit of the firms. She argues that this linkage has negative consequences for informal labour because it has cheapened labour, and working conditions have deteriorated.

Further, informal workers in Kenya and Nigeria, the two countries Meagher (1995) studied, work longer hours, demand no formal wages and have minimal overheads. Bullock (1995) argues that there is a growing body of research focusing on value chains of goods and services. Value chains involve the full range of activities and stakeholders who are involved in bringing a product from conception, sourcing of raw materials, marketing, distribution and delivery to the final consumer. It is evident that stakeholders in the informal economy, in the manufacturing and more particularly the retailing of goods, play a significant role in many of these value chains.

Rogerson and Hirschowitz (1991) argue that the scope of informal businesses in South Africa is more limited compared to other developing countries. They argue that in South Africa there are vast numbers of service and distribution businesses and relatively few based on direct production. However they seem to support De Soto's (1989) views on legislating the informal sector. The two scholars just cited above point out that in South Africa the need for deregulation has been widely recognized and is indeed taking place in certain municipalities. Deregulation as a policy is also reflected in the thinking of central government. It seems highly likely, however, that deregulation in itself will not be sufficient to promote the development of the informal sector.

Rogerson (1995) argues that a multifaceted policy is needed for a substantial impact to be made, based on branch by branch analysis of business in the sector. There is a need to understand both internal and external constraints confronting informal businesses. A clear distinction is drawn between the needs of survival businesses and those with a potential to grow. Survival businesses require interventions linked to poverty relief and upliftment, for example, the supply of safe drinking water. Industries with potential on the other hand, require interventions that help to overcome problems preventing expansion, for example acquiring technical, managerial and administrative skills. He also points to the need for building networks among informal business-entrepreneurs. Rogerson (1995) then considers the areas of business linkages and sub-contracting as important trends to encourage through future policies. Technological capacity would however need to be upgraded. With sub-contracting, there is a danger of the exploitation of workers in sweatshop conditions, but there are also the advantages of learning from an experienced entrepreneur.

## 2.11 Conclusion

The role played by the informal sector both in South Africa and the world cannot be denied, especially in the sphere of economic regeneration and growth. Indeed, one observes a growing belief that entrepreneurship, especially amongst African small-business people, will prove to be the panacea for South Africa's economic ills. But skeptics have questioned the effectiveness of a development strategy which accords the informal sector the role of employment generator. Manning (1993) notes that some analysts argue that informal enterprises occupy a highly vulnerable position relative to large firms, casting doubt on the security of jobs in the informal sector as noted by.

Manning (1993) contends that in the international literature, it is common to find two broad positions on the issue of the informal sector: firstly, that which is optimistic of the potential that the informal sector offers to solve economic problems; and, secondly, that which denies that any developmental role can be played by the informal sector, arguing that it represents that part of the economy which perpetuates poverty and vulnerability. Adherents to the first position stem from two distinct schools. The first is the neo-liberal tradition, best articulated by Hernando De Soto in his work, *The Other Path* (1986), in which, as has been set out above, he presents the informal sector as a revolutionary development, offering the potential for developing countries to resolve the macro-economic problems plaguing them (such as the debt problem).

De Soto (1986) portrays participants in the informal sector as victims of excessive government regulations, who have rebelled against the mercantilist system which excluded most Peruvians from business opportunities. According to this position, the retreat of the state from economic activities will free the informal sector from the restrictions it faces, allow the vast entrepreneurial reserves of the country to be tapped, and promote growth and dynamism in the informal sector in a genuinely laissez faire system of capitalism, free from market imperfections. It is from a very different position that other proponents of the developmental potential of the informal sector emerge, best exemplified by the position adopted in the numerous ILO studies on the informal sector, as illustrated in the first chapter. The starting point of this position lies in the crisis of the economy, which is argued to be structurally incapable of absorbing large sections of the labour force. Whilst this position starts by recognising that the origins of the informal sector lie in

economic crisis, it perceives the informal sector as having the potential to temper this crisis by creating jobs, increasing output, and thereby facilitating the more efficient use of the economy's human and physical resources.

The next chapter will discuss the history of the informal sector in South Africa. Information will be provided on how the apartheid government viewed the informal sector.

## **CHAPTER THREE:**

### **THE POLICIES AND POLITICS OF THE INFORMAL SECTOR IN SOUTH AFRICA**

#### **3.1 Introduction**

Cant and Brink (1989) write that an understanding of the current status and circumstances of informal black business necessitates an analysis of the development of black business and the policies of the South African Government in regard to black people on a general level and at the specific level of black business. Skinner and Lund (2005) observe that apartheid policy was central in the formation and distortion of the South African informal economy. Flexible and informal forms of labour are historically characteristic of the South African labour market. A key element of apartheid was a system of contract and migrant labour. Apartheid restrictions not only limited opportunities in the formal economy for black South Africans, but also placed a series of restrictions on the right of African entrepreneurs to establish and operate businesses. Apartheid legalisation limited the range of goods that could be sold, blocked the formation of companies by African people, and set up an array of bureaucratic processes that discouraged the registration of small-scale economic activity.

The impact of more than a century of repressive legislation on the development of informal economy activities by African people should not be underestimated. The informal sector in South Africa is an important element of South Africa's urban landscape and contributes to the economic growth of South Africa and can no longer be ignored. The development of the informal sector in South Africa can be divided into four important periods. The following section will briefly look at the four periods.

#### **3.2 Historical Analysis**

- **Period from nineteenth Century to 1976.** The period up to 1976 was characterised by the particular target of the African trader as a way of preventing him from taking “control of public space” (Bromley 2000, p.1). This was also in support of the then prevailing political ideology. It is important to note that the policies and other restrictive measures of the past have a direct bearing on the situation in which the black trader finds himself at present.

- **Period from 1976 to 1985.** After the 1976 Soweto uprising there was a significance shift in the psyche of the government and that propelled the establishment of the vigorous encouragement of African business in the townships (Cant and Brink, 1998).
- **Period from 1986 to 1994.** Cant and Brink (1989) write that Throughout the period from 1986 until 1994 all the laws that prohibited black businesses in the townships were abolished.
- **Period from 1994.** They point out that after the first democratic elections of 1994 the focus shifted to economic empowerment of black business.

### **3.3 Political Factors Affecting the Informal Sector in South Africa**

#### **3.3.1 Period up to 1976**

The discovery of commercial quantities of gold in the former Transvaal of South Africa in 1896 came twenty years after the exploitation of diamonds in the Northern Cape. Labour practices followed the existing migratory pattern for domestic and foreign labour in industry, a pattern which exists to this day. Gold miners, like diamond miners, were accommodated in compounds, often segregated by ethnic groups, and contracted for 18-month stints with no certainty of reengagement. The mineral discoveries had a radical impact on every sphere of society. Labour was required on a massive scale and could only be provided by Africans who had to be drawn away from the land (Callinicos, 1986).

Early apartheid (up to around 1930) was buttressed by a coordination failure. Mining and agriculture were the dominant sectors (Nattrass 1981). For technological reasons the mines required large quantities of skilled labour and even larger quantities of unskilled labour (Austen 1987). The requirement for skilled labour was largely met by whites. In order to meet its unskilled labour requirement, the mining houses, with the assistance of the state, engineered a monopolistic labour market for black labour. This system worked by repressing economic alternatives of blacks (for example by restricting the amount of land available to them), by exerting close supervision both on the job and in black workers' urban quarters, and by

maintaining a system of circular migration from rural areas rather than allowing blacks to settle permanently in urban areas.

For the white authorities the chief consideration was ensuring a labour supply and undermining black competition on the land. Conquest, land dispossession, taxation and pass laws were designed to force black people off the land and channel them into labour markets, especially to meet the needs of the mines. Gradually, the alternatives available to them were closed, and the decline of the homestead economy made wage labour increasingly essential for survival. The integration of Africans into the emerging urban and industrial society of South Africa should have followed these developments, but short-term, recurrent labour migrants suited employers and the authorities who sought to entrench the system. The closed compounds pioneered on the diamond fields as a means of migrant labour control, were replicated at the gold mines. The preservation of communal areas from which migrants could be drawn had the effect of lowering wages by denying Africans rights within the urban areas and keeping their families and dependants on subsistence plots in the reserves (Preston-Whyte and Rogerson, 1991).

The apartheid government had to ensure that any form of trading amongst Africans was enforced through the establishment of laws that regulated the place of African people in the economy such as the Native Land Act (1913) which prevented all blacks, except those in the Cape, from buying land outside 'reserves'; the Natives in Urban Areas Bill (1918) designed to force blacks into 'locations'; the Urban Areas Act (1923) which introduced residential segregation in South Africa and provided cheap labour for the white mining and farming industry; the Colour Bar Act (1926), preventing blacks from practising skilled trades; the Native Administration Act (1927) that made the British Crown, rather than paramount chiefs, the supreme head over all African affairs; the Native Land and Trust Act (1936) that complemented the 1913 Native Land Act and, in the same year, the Representation of Natives Act, which removed blacks from the Cape voters' roll. The most important act that stamped the authority of the apartheid government in terms of repression was the 1920's Native (Urban Areas) Act stipulating that African people were only allowed in municipal areas as long as their labour was in demand by the white population. The act gave local authorities the right to control trading locations with the allocation of trading licences and prohibited street trading when necessary (Beavon, 1989, pp 20-21).

Preston-Whyte and Rogerson (1991) argue that the system of apartheid served to distort many aspects of urbanisation in South Africa including the development of the informal economy in South Africa's urban areas. The government's policies of influx control, which debarred Africans from migrating to the cities legally, mass arrests and the forced removal of 'illegal' Africans in the urban areas, led to a slowing down of the process of urbanisation. The slow growth of urbanisation was imperative for the successful implementation of apartheid. Part of this overall strategy to stall urbanisation was the repression of the emergent urban informal economic sector since it would provide the unwelcome in-migrants with a means of survival. Under apartheid the government opposed the informal economy, especially the black entrepreneur, which essentially forced black people into the underground economy, without many job opportunities in their hometowns. Mazwai (1991) writes that since 1948 black business has been pushed into poverty by various laws and regulations. Cant and Brink (1989) point to Ramalla (1989) who draws attention to the report of the Tomlinson Commission which, in 1955 confirmed the notion that tribal homelands could be developed and made so attractive that the influx of black people to white areas would be completely stemmed and even reversed in due course.

After 1948 the introduction of severe restrictions hampered the entry of black business into formal businessmen in the white cities (ibid). This resulted in the urban local authorities controlling the allocation of trading spaces within townships and urban areas from 1923. In fact, it was not until 1976 that trading sites could be used for non-daily essentials for living. Initially, authorities applied regulations to hawkers to stop the activities of so-called "cheap jacks" who were white and "tricksters who sold cheap goods to the gullible public" (Beavon, 1989, p. 28). These regulations eventually encompassed Africans and people of colour. The Blacks Urban Areas Consolidation Act of 1945 restricted African urban businesses. This was done to prevent rural migration to urban areas and to protect white business from competition. Additional laws such as the Group Areas Act of 1966, the Licenses Act of 1966 the Wage Act of 1967, and the Health Act of 1977, all had the effect of preventing African people from operating businesses. One estimate said that there were as many as 40 compliances that had to be made before a business could be registered legally (Standing, Sender and Weeks, 1996). However Ramalla



(1989) observes that even in the townships the freedom of entrepreneurs to establish and expand their business undertakings was seriously curtailed.

### **3.3.2 Period 1976 to 1985**

Cant and Brink (1989) point out that according to Butler (1989) the years following the Soweto Riots, various restrictions affecting black business were lifted. The government felt a need to hold discussions with black leaders, and for the first time acknowledged the importance of black business leaders. As a result of this feeling initiatives were taken, including a sharp focus on the need for expanding the scope of black business. In 1976 the types of business permitted in urban black townships was increased to 26 from the original seven. Kroon (1986) The events of 1976 thus led to the acceptance of the argument for permanence of black residential areas and a greater awareness of the necessity for the development of these areas which, among other things, led to the easing of regulations on business in black residential areas, albeit over many years.

Mazwai (1991) writes that in 1984 the ‘sleeping giant’ the black consumer market made its presence felt in another way than had been predicted years previously. Black consumers were urged to boycott white shops to force the government to negotiate. Black businesses were forced to align themselves with the masses and thereby win the support of black consumers. Initially the consumer boycott benefited black business but this was short-lived as wholesalers could not get into townships to supply businesses, or their price soared to offer the risks they were taking. ‘In a rather bizarre way, the township dealer had become the traditional whipping boy of South African politics. Whether politics blew hot or cold he always had the short end of the stick’ (Mazwai 1991, p. 26).

Cant and Brink (1989) observe that the move in South Africa for the entire deregulation of small business black and white commenced when the first official document on deregulation was submitted by the Committee for Economic Affairs (President’s Council Report 1984). The Committee presented its report in response to a request by the State President to the President’s Council to advise him on measures that restricted the effective functioning of a free-market-oriented economic system, with due allowance for the plural composition of the population of the Republic of South Africa. The Committee accepted as a basic premise that freedom and

equity are best served by a system based on private enterprise or the profit motive in which initiative is permitted the maximum scope, provided it does not restrain other individuals from exercising such initiative. Everyone should, it stated, have equal opportunities and, where necessary and as far as practically possible, be supported and assisted to create greater prosperity and wealth through the market system. In order to effect meaningful participation in the economy by the lesser-developed population groups must therefore experience the advantage of the market system if they are to accept it. The Committee argued strongly for the development of a cadre of entrepreneurs, stating that the development of a larger entrepreneur cadre is of the utmost importance in creating opportunities for greater participation in economic activity by the lesser-developed population groups.

### **3.3.3 Period 1986 to April 1994**

Harrison (1992) on the one hand observed that the 1986 White Paper saw urbanisation as an economically beneficial and socially desirable process, it emphasised the need for urbanisation to be planned ordered and directed. On the other hand the Race Relations Survey (1986) argued that the White Paper on urbanisation accepted the permanence of black people in South Africa. The White Paper coincided with the repeal of most of the pass laws as implemented by influx control in terms of the Blacks (Urban Areas) Consolidation Act. In addition, full property ownership rights in black townships came into effect. The desegregation of trading areas took a step forward when the central trading districts in Johannesburg and Durban were opened for trading by all races including black Africans who were denied this privilege. This meant that members of all population groups could now freely obtain occupation and ownership rights of business premises in the proclaimed area. By the end of 1986 a total of 29 central business districts had been opened to traders of all races.

Butler (1989) notes that the Sunnyside Group an association of approximately 40 agencies representing nearly 150 000 small businessmen with the aim of promoting small business development, initiated the lobbying force on deregulation. Butler says that the main aim of this group was to formulate a set of proposals on small business, the informal sector and the unemployed, that were to be presented to the government. The Race Relations Survey (1991) notes that the repeal of major apartheid laws in 1991 helped pave the way for multiracial

constitutional negotiations which began in December 1991. The Group Areas Act and other major institutional pillars of apartheid and discrimination pillars were repealed, paving the way for black business to operate freely for the first time. Nafcoc resolved in 1992 that it should demand greater participation for black people at all levels of the economy, among other things, affirmative action legislation, support mechanisms for black business, and a small business administration department which could provide soft loans and technical assistance to black business. However, informal businesses were not seen as warranting of the inclusion into these negotiations.

### **3.3.4 Period April 1994 to 1998**

Peter Cromberge (2006) points out that since 1994, much argument has been focused on what often appears to be two contrasting economic poles that, although different in form and function, have one important theme in common: they both belong to South Africa. Comberge (2006) is also of the opinion that the debate around the nature of South Africa's economy was provoked by President Thabo Mbeki when he referred to the country's 'Third World economy' in 2003. Mbeki's metaphor has opened up the institutional floodgates of analysis concerning the nature of the country's 'two economies' as stated in the previous chapter.

Kirsten (2005) opines the concepts of economic retardation and inequality among the black population were intimately linked through a web of apartheid legislation and this legacy has given rise to the entrenchment of some economic biases in economic structures. The South African government's "Towards a Ten Year Review of 2003" states that despite impressive gains in the first economy, "the benefits of growth have yet to reach the second economy and, with the enormity of the challenges arising from the social transition, the second economy risks falling further behind if there is no decisive government intervention".

When the ANC government came into power in 1994 it sort to normalize South African society and its economy by initiatives such as the Reconstruction and Distribution Programme (RDP). This was seen as a move to augment what the apartheid government had succeeded in doing, that is, excluding blacks from the economy. Various groups came together to look into questions of macro-economics, black business, education, health, housing, land, electrification, water, youth, women, and so on. The RDP thus became a broad policy framework of integrated and social

change. It was also suggested by business organizations such as Nafcoc that the RDP should be business-friendly and should not allow for government intervention in the running of business organizations, rather the role of government should be to create an environment for markets to operate more effectively (Race Relations Survey, 1994).

The ANC undertook the restructuring of the SBDC in order to provide adequate finance to meet the needs of small business to:

- Ensure the availability of properly serviced sites for small traders and informal markets.
- Offer training to small business in management, accounting, marketing and production.
- Ensure equal access to loan capital, credit licenses and sites.

According to Mashigo (1992) most black traders were at a disadvantage when they applied for loans from banks because they lacked collateral. He called for the relaxation of the stringent requirements affecting black businessmen and a restructuring of credit criteria because existing criteria had served only to meet the needs of whites. The above point is also echoed by De Soto in the previous chapter. De Soto (1989) observes that the Third World's poor tend to possess de facto control over surprisingly large amounts of assets, such as houses, land, and small businesses. Yet this section of society finds it difficult to use its possessions as collateral to borrow money to invest in starting small businesses. Hence the emphasis on government intervention to focus on policies that will address the challenges faced by informal traders in an equitable way. The following section will look at the hindrances to forming links between informal and corporate businesses in South Africa.

### **3.4 Barriers to Forming Links between Informal and Corporate businesses**

South Africa has increased political participation, achieved macroeconomic stabilization and restored growth. Despite these achievements, millions of people in this country remain excluded from the political and economic system and still live in poverty. A glaring symptom of this exclusion is the growing number of entrepreneurs who are engaged in low-income, low-growth business activities outside the formal economy. These citizens feel that democracy and market based economy have not brought them the expected benefits. As a result, an increasing number

of citizens in emerging democracies and economies are disappointed and disillusioned. This is the case especially in South Africa where the current system of neo-liberal democratic capitalism is inappropriate to a developing country and has given rise to what has been acknowledged in formal circles as “jobless economic growth” (Trevor Manuel, Morning live SABC interview, 2007).

In order to consolidate democratic and market-oriented transitions, it is imperative to understand why South Africa’s economic growth is ironically accompanied by joblessness then devise viable solutions. The underlying reason why many citizens in emerging democratic market systems do not participate in the political system or the formal economy is that the institutional structures or the “rules of the game” prevent them from doing so. In other words, there are barriers to participation in the formal political and economic systems. Kuchta-Helbling (2000) argues that these barriers exist in spite of democratic elections for public offices. Holding free and fair elections regularly is the essential first step towards a participatory political system. The next step, removing obstacles to routine, daily public participation in national and local decision-making is receiving increased attention worldwide, and is essential to improving the practice of democratic governance. Kuchta-Helbling (2000) observes that until the barriers are removed, democratic governance and economic growth will continue to be hindered. The focus in this section is on types of barriers to economic participation: the cost of doing business in the formal economy and will discuss how these barriers jeopardize the consolidation of economic transitions. Examples of the costs of conducting business in the formal sector include:

- obtaining a business license
- acquiring land titles or leases
- hiring employees
- knowing and complying with applicable government laws and regulations
- obtaining information about the price, quality and quantity of particular goods and services, about sources of goods and services, and about potential customers
- obtaining a loan
- buying supplies
- hooking up and maintaining electricity and telephone services

- paying taxes
- enforcing contracts, and so forth.

Taneja and Pohits (2000) point out that, key determinants of transaction costs in a particular country are the institutions, i.e., the rules and regulations that affect economic activities. Well-designed institutions provide entrepreneurs with a predictable framework and necessary business information at a cost that encourages them to comply with and pay for these institutions. Poorly designed institutions require entrepreneurs to comply with burdensome rules and regulations and deal with inefficient, corrupt government agencies, and offer few benefits in return. Such institutions increase transaction costs, lower entrepreneurs' incentives to comply, and hinder political and economic participation.

Kuchta-Helbling (2000) seems to agree with De Soto's (2000) views on informality by illustrating that one of the most important institutions contributing to the success of capitalism is the formal property rights system. This system provides the legal mechanisms through which assets can be converted into capital and used to create additional value, increase productivity and growth (De Soto 2000). While virtually every country has a formal property rights system and acknowledges its importance, in developing countries the general public does not benefit from such institutions for two reasons. The first is that formal law has often been crafted by and for an upper-class minority as has been the case in the Mbeki era in South Africa, and thereby does not reflect the concerns and norms of the general public. The second reason is that the enormous costs in terms of time and money necessary to acquire formal property rights in developing countries often outweigh the benefits. Entrepreneurs of modest means without political influence simply do not have the resources or the incentives to comply with costly laws and regulations including obtaining formal property rights, acquiring a business permit or maintaining legal accounting records. Locked out of formal, wealth creating institutions, these entrepreneurs operate informally in small-scale, short-term, low-investment and low surplus-generating activities or they do not engage in business at all. This greatly hinders growth (Kuchta-Helbling, 2000)

Moreover, these entrepreneurs are often excluded from policymaking or lawmaking processes. As a result, government is not held accountable for their concerns and democracy is weakened. This creates an opportunity for a small number of politically active oligarchs to control the nation's economy through a system of politically-motivated, state-endorsed laws and regulations at the expense of the rest of the population who eke out a living in the informal sector. Loayza (1997, p. 2) echoes the above point in writing that, "To the extent that excessive regulations are created to benefit particular interest groups and not society in general, the presence of the informal sector is a result of the failure of political institutions to protect and promote an efficient market economy." In addition, lack of democratic and market-based institutions imperils the competitiveness of an economy and weakens its ability to take advantage of globalization. In short, poorly designed institutions bar entrepreneurs from or discourage their participation in the political and economic system. Hence, they operate in the informal sector. This has serious implications for the future of political and economic transition in emerging democracies and economies like South Africa and thus warrants attention.

Cromberge (2006) notes that also of concern is the need to create a rainy season of empowerment for the previously disadvantaged, as opposed to a cloudburst for a privileged few. The irony of the local economic situation lies in the pattern that has seen the country enjoy positive GDP growth for some 20 quarters while poverty rates have risen from 15.5% in 1995 to 30.5% in 1992 (Cromberge, 2006). For Kirsten (2005), a real challenge for government is to help the second economy obtain finance and market-related information on how and where to target their services and to cash in on the growing linkages between the first and second economies. Kirsten (2005) writes that any industry with established linkages between the first and second economies has the potential to correct previous imbalances. She emphasizes that "It is only through linkages that sustainability can be improved".

### **3.5 Conclusion**

The South African government has controlled the informal sector since the early 1900s with regulations designed to render the African majority submissive through economic disadvantage or subservience. The informal sector, however, has endured because its participants depended on the market for individual survival. There have been many attempts to define the informal sector,

but generally it has been seen as a sector that employs the formally unemployed and its business is entrepreneurial in nature. Negative concepts have plagued much of the progress of the informal sector, especially the view by governments that the sector is not commercially viable. The argument offered in this chapter is not that informal or small firms are a desirable characteristic of any economy. Rather, I suggest that in conditions of high unemployment and escalating poverty such as that currently prevailing in South Africa, the informal sector presents itself as an effective vehicle of income generation, as has been the case since the 18<sup>th</sup> century in this country. African people were forced into the informal economy in order to survive. The South African government has to take that into consideration and devise policies that will enhance this sector. We need a government that is radical and not apologetic to a privileged few; a government that ensures the sustainability of the informal sector through the implementation of policies that encourages corporate South Africa to get involved in developing a sustainable relationship with the informal sector.

In the previous section it was pointed out that the discriminatory measures of the past had retarded the development of black business and the black trader in particular. The next chapter will discuss the results from interviews with traders in the markets and on the streets of Diepsloot.



## **CHAPTER FOUR:**

### **DIEPSLOOT INFORMAL SECTOR RESEARCH FINDINGS**

#### **4.1 Introduction**

This chapter focuses on the experiences and dynamics of informal businesses in the Diepsloot informal settlement. The chapter begins by highlighting the geographical area of Diepsloot. This is followed by the personal and business profile of the research participants whose businesses operate in the area. The participants' business information is central to the study as it gives a clear indication of what type of informal businesses operate in these informal settlements as well as their dynamics of networks. The research also identifies the reasons behind the lack of partnerships between informal and formal businesses. This chapter is not exhaustive of the complex issues affecting businesses in informal settlements. It does reflect, however, some of the challenges that are experienced by informal businesses in informal settlements.

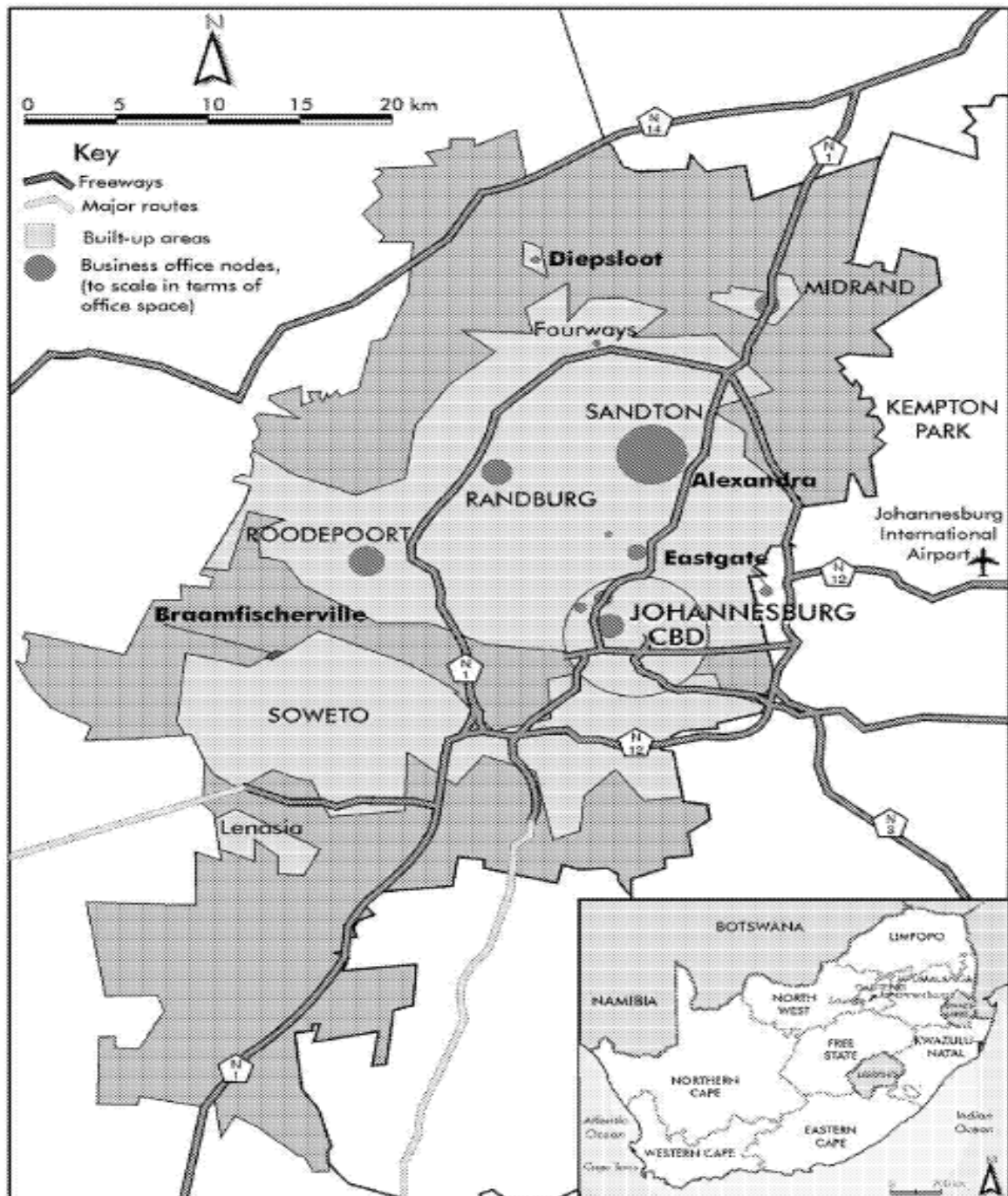
#### **4.2 Locality of Diepsloot**

Diepsloot is situated approximately 30km north of Johannesburg Central, 20km north of the Sandton CBD, to the west of the Ben Schoeman (N1) freeway which is the main north-south link between the Tshwane and Johannesburg metropolitan areas. It is thus situated in between the urban areas of Johannesburg and Tshwane. The area is bordered by the Mogale-Tshwane Highway (N14) in the north, William Nicol Drive (R511) in the east and the Diepsloot sewer works to the south. It is largely surrounded by agricultural land, but is also located about 6km from Lanseria airport, the Kya Sands industrial-commercial area and the retail centres of Northgate and Fourways.

Urban planning under apartheid South Africa has played a fundamental role in segregating cities along racial lines (Sihlongonyane and Karam, 2003), which essentially means that the city is still divided into racial segments. The above point illustrates how little has changed in the new spatial configuration.

## Location Map of Diepsloot

Figure 4.1 Source: Location of the study area. Adapted from Bernstein (2002) cited in Ramatsindela (2002)



### 4.3 History of Diepsloot

According to Alan Kitchin, the special projects assistant director in the City of Johannesburg's housing department, the influx of people from Alexandra placed further strain on the already stretched resources in Diepsloot (COJ, 2004). The density of the area is reported to be at approximately 1 076 people per square kilometer (Development Programme for Diepsloot May, 2007). The 2001 census figures for the broader area (wards 95 and 96 combined) indicate a total of 13 017 households living in formal dwellings, and 20 517 households live in informal dwellings and 16.3 percent of the latter group live on invaded land (Census, 2001). The Regional Spatial Development Framework (RSDF) indicates most people are not permanent residents of the area, but it does not provide statistical detail substantiating this statement (RSDF 2006). The settlement is now home to about 55 000 people and some of the relocated families do not qualify for housing benefits.

Diepsloot is a poor area, evidenced by the fact that 76 percent of households spend less than R400 a month and the unemployment rate stands at 58 percent (Statistics South Africa 2002) from 48 percent in 2001 (Baseline Surveys). The shacks are in 3m-by-2m. These are typically assembled from scrap metal, wood, plastic and cardboard. Some families lack access to basic services such as running water, sewage and rubbish removal. A lot of residents use paraffin stoves and coal for cooking, and candles for light. City officials estimate that half the population in the settlement is unemployed.

It is typically an informal settlement made up of closely spaced tin-shacks known as "*mkhukhus*" in the whole area. These are so closely spaced that vehicular access is virtually impossible. The shacks are typically covered with either cardboard boxes or heavy plastic sheets that act as either insulators or protection from rain. The area lacks basic services and open-air drainage forms small streams that eventually flow down slope in the undulating landscape of the region. Thus, sprawling with shacks and decaying infrastructure, which serves as a pathological disaster for urban planning.

Figure 4.2: Informal Traders on the William Nicol Highway. This position gives them maximum visibility to their customers.



During field work it was observed that the streets are ungraded, chaotic and bustling with activity. Along the main road, busy thoroughfares and street traders can be found selling goods ranging from vegetables to traditional medicine, including counterfeit Chinese Nikes, and other luxury goods. This tendency has generally been observed in Africa. Simone (2000) argues that poverty drags urban economies, as populations hedge the deployment of available physical and social capital, making the consolidation of scale and planning necessary to development difficult. In trying to cope with the difficulties of everyday life, households engage in multiple income generating activities instead of specialising in the development and growth of a particular economic activity. Holdings are often fragmented into multiple plots, and many urban households combine subsistence cultivation, petty trade, and wage labour. Some are there because they have lost their jobs in the formal sector. They face the challenges of operating their businesses informally on the streets every day. They rise at dawn to sell to people on their way to work and tend to be the last to leave the streets hoping those on their way home will purchase their goods.

Figure 4.3: Informal Trader on William Nicol Highway. Goods displayed on the simplest Infrastructure for exposure.



A proportion of 39 percent of the people live in subsidized housing areas, 36 percent in Diepsloot West and 38 percent, in the Reception Area. A further 16.3 percent have invaded land in the Reception Area and Diepsloot West (Baseline Survey 2001). In addition to housing, the major problems confronting the population include poverty, unemployment, lack of social and economic opportunities, and limited public transport. Unemployment levels are reported to be at about 53 percent among the potential labour force, with 73 percent living below the poverty line (Baseline Survey, 2001).

Informal businesses predominate along streets that form the major taxi routes such as the William Nicol highway and inside the township. These are largely survivalist enterprises and operate with fierce competition in a customer base that is bracketed by meager income. There are currently no specific bylaws for the area regarding informal business enterprises, but Municipal officials indicated that the City of Johannesburg is in the process of creating bylaws to regulate informal business enterprises in Diepsloot. There are also formal business developments in the area such as hardware stores and supermarkets along informal settlement roads. While initial



plans included a centrally located commercial area, the project was unable to successfully negotiate for the identified land with the private owner. A shopping centre has only recently been

Figure 4.4: Customer looking at training shoes and negotiating a price. The labels are varied and often times include fake goods.



developed in the southern tip of the settlement along William Nicol Drive. It presents an intrusive commercial activity, likely to further degrade the informal business in the area and ironically exacerbate poverty. It has converted the informal businesses into its involuntary distributors of its goods. Nattrass (1986, p. 105) notes that “once big business perceives informal businesses as either a threat or an opportunity, it is highly likely that the former will use its economic muscle to its own advantage by either eliminating the competition in the first instance, or through a take-over of the small business”.

Figure 4: Modern shopping mall complex situated next to Diepsloot informal settlement. Informal traders ply their goods along the walkways to the mall to compete for customers.



#### 4.4. Preparation for interviews with Traders

The researcher spent five days in Diepsloot, engaging with traders in the streets, councilors and business leaders. The purpose of the engagement was to gain sufficient information to establish a context within which to develop a set of questions that would be used in interviews with the traders. The aim of these questions was to elicit details of their lives and business situation, to enable the researcher to:

- draw up a detailed profile of the trader on the street;
- determine whether traders do better on the streets as solo enterprises (without any partners);
- discover whether there is normally any form of partnership between informal traders and corporate South Africa;

- ask them whether they would be willing to develop a business relationship with a company in the formal sector (in the event that they do not have one);
- describe what challenges the traders face;
- find out what type of assistance traders thought they would benefit from; and
- establish how effectively their councilors helped them address problems.

#### **4.4.1 Age and Gender**

The 12 traders that were interviewed fell into a wide range of ages: 25 and 65. Four were between the ages 25 and 35; five between of 35 to 50, only three fell into the older category of 55-65. This signifies the wide spread nature of unemployment across generations and age groups. The gender composition showed a slight inequality in that seven were females and five males. It should be noted that this gender representation, although based on a small sample, clearly suggests the dominant role women play in supporting their families. Confirmation is provided in a survey conducted by Baseline in 2001, which shows that in Diepsloot informal businesses are predominantly run by women. The high proportion of female participation in the informal sector is also attributed to the marginalisation of women in employment creation policies. It can be argued that unemployment in South Africa is structural in nature.

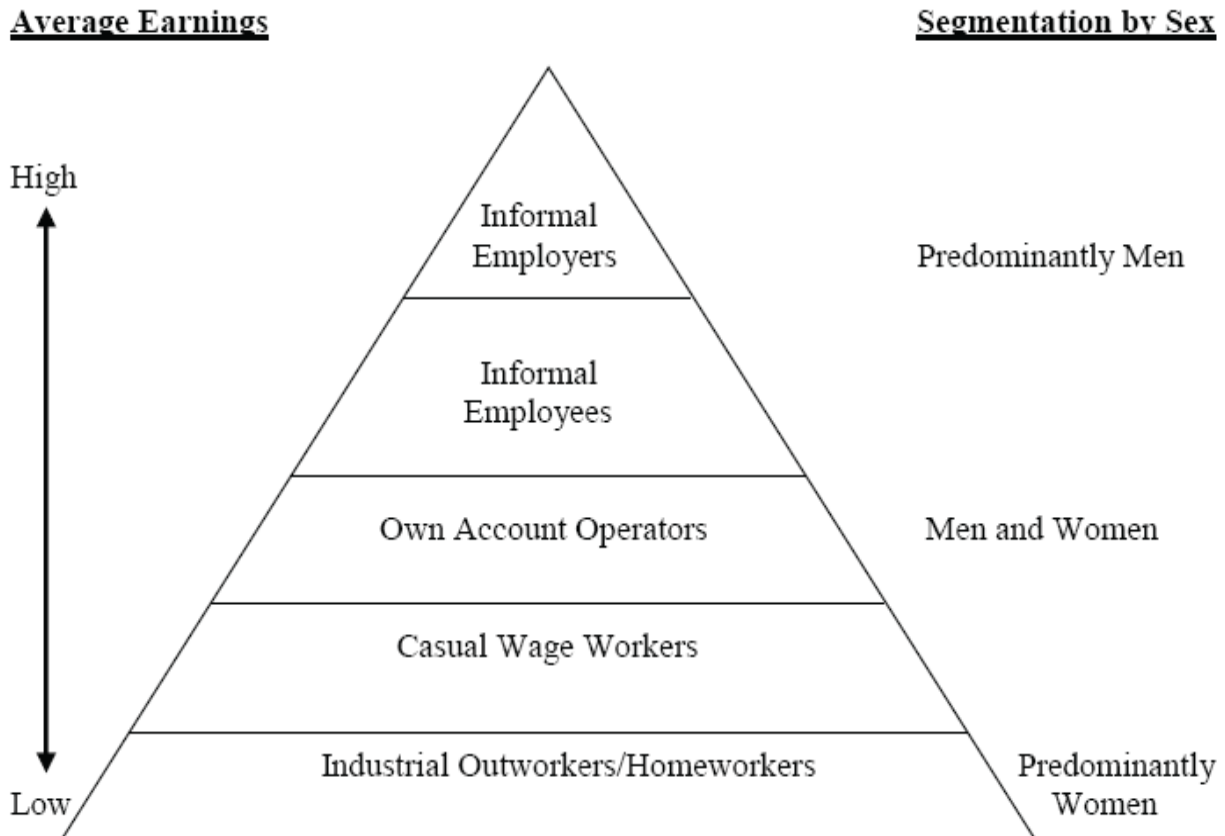
The above finding could be attributed to a variety of factors. For instance, Chen (2007) argues that the informal sector is generally a larger source of employment for women than for men in the developing world. In sub-Saharan Africa, 84 percent of female workers outside the agricultural sector are informally employed, compared with 63 percent of men while in Latin America the figures are 58 percent of women in comparison to 48 percent of men. In Asia, the proportion is 65 percent for both women and men. This survey found that women made up 75 percent of street vendors in these cities; and that females accounted for 26 percent of traders in the urban informal sector and 24 percent of the total urban workforce (data compiled by Charmes, presented in ILO 2002).

This means that South Africa is on par with other developing nations regarding women's involvement in the informal sector. However, it is important to note that all of the female respondents who were interviewed with the exception of one are involved in extremely survivalist activity. Preston-Whyte and Nene (1984) observes that woman tend to concentrate on



a narrow range of poorly-paid activities. Chen (2007) concurs and points out that globally, men tend to be over-represented in the top segment. Women tend to be over-represented in the bottom segments and the shares of men and women in the intermediate segments tend to vary across sectors and countries. These observations are depicted graphically in Figure 4.6.

**Figure 4.6: Segmentation of Informal Employment by Average Earnings and Gender**



Source: Chen 2007

#### 4.4.2. Place Where They Were Born

About half of the traders were born in rural areas and the rest were born in urban areas. Most of the people in this community came from rural areas to Diepsloot seeking employment in the mines and construction companies. Hemlin et al (2007) point out that according to a social survey conducted by Setplan in 1999, the largest proportion of the community had come from Alexandra (42 percent), followed by Skotipol (15 percent) and Randburg (14 percent). What this

suggests is that out of the 42 percent that came from Alexandra, the majority were not originally from Johannesburg.

The survey states that the reasons for migrations had to do with the fact that most households were forced to move (29, 5 percent) and others moved in order to be closer to work (26, 9 percent). Others reasons stated are that they moved to Diepsloot to look for work or housing opportunities. Since the vast majority of people originated from the surrounding areas, Diepsloot is understood to have initially reflected the local housing crisis rather than rural-urban migration. The vast majority of households surveyed following the Alexandra removals in 2001 stated that they did not want to move, citing various reasons. In its fact finding mission the South African Human Rights Council (SAHRC), found that people had not been properly consulted about the move. Unnecessary force was allegedly used and children had been removed from school without any plans in place to ensure that they were absorbed into schools in the new location (Ramatsindela 2002). This shows that Diepsloot has typically become the reception area for post-apartheid practices of urban displacement.

#### **4.4.3. Educational levels**

All the traders that were interviewed did go to school although about 5 percent completed Matric. About 75 percent of those interviewed reached secondary school, and almost 20 percent finished primary school. None of those interviewed had a university education. Almost all those interviewed cited challenges they faced at home as a reason for not continuing with school. They had to leave school and concentrate on generating income in order to ensure that their siblings were able to continue with school. In this case the lack of relevant skills or qualifications prevented individuals from filling available jobs in the economy (Dias 2002). However, it is interesting that the low level of education has not been a hindrance in terms of making decisions regarding the generation of income. This also says a lot about the indelible mark of educational inequalities that are a legacy of apartheid education.

#### **4.4.4 Distribution of Premises**

The most striking finding in this research is that more females 33 percent compared to males 19 percent operated their businesses in open spaces. This observation reiterates the findings of the Ministry of Labour (MOL) survey (1997) which looked at the kind of premises used by informal

businesses. The survey revealed that 56 percent of the males operated from permanent premises, 19 percent from open spaces and 12 percent from temporary premises. With regard to women-owned businesses, 47 percent operated from permanent premises, whereas 33 percent operated from open spaces and a further 13 percent operated from temporary premises. This means that more women could not afford to operate from permanent premises or even temporary ones. This reflects the structural gender inequalities in the informal sector. Chen (2007) points out that this difference can be explained among other factors, by the fact that men tend to embody more human capital due to educational discrimination against girls, especially in certain societies (e.g. in North India, Pakistan and most countries in Africa).

This difference can also be explained by the fact that men tend to have better tools of the trade, operate from better work sites or spaces and have greater access to productive assets and financial capital (Chen, 2007). As a result, men often produce or sell a higher volume or a different range of goods and services. For instance, among street traders in some countries, men are more likely to sell non-perishables while women are more likely to sell perishable goods such as fruits and vegetables. In addition, men are more likely to sell from push-carts or bicycles while women are more likely to sell from baskets or simply from a cloth spread on the ground.

#### **4.4.5 Income and Working Conditions**

All those interviewed in this research live in homes they built themselves with profits from their informal businesses even those that were doing well. They all pride themselves in the fact that they have achieved so much with no help from government or corporate South Africa. The respondents, especially men, were very proud of their self-sustenance. These are proud African men doing well on their own, not waiting for government handouts. They were quick to point out how they have been able to build their own homes with their profits, educate their children, and in some cases employ people. This was summed up by one of the male respondents aged 55, who mentioned that:

*“Despite the challenges I have faced and no help from government, being looked down upon, I have been able to build my wife and children a beautiful home. However, the most important fact is that on our own we have survived well. Imagine if government would force these big companies to help us. We would be far” (10 September 2008).*

Their source of working capital was mainly borrowed from friends and family. Only two respondents started informal businesses with their own money, either from the previous job or saved whilst employed formally. As one respondent explained:

*“When I was fired from my job, I went back home to the Eastern Cape where my parents still live. I used the money the company had paid me to pay off all my debts back. When I came back to Johannesburg I had to borrow money to start up this business, after I paid off the borrowed funds from my friends, I never borrowed again. I have managed to do relatively well ever since” (interviewed 10 September 2008).*

The above point suggests that some kind of partnerships exist within the community. This relates to Putman’s (1993) observation of dense social networks. These are often based on the extended family or on close-knit ethnic communities social capital is a “public good.” Like other goods, “social capital is akin to what Tom Wolfe called the ‘favor bank’ in his novel, *The Bonfire of the Vanities*,” notes economist Robert Frank. A society that relies on generalized reciprocity is more efficient than a distrustful society, for the same reason that money is more efficient than barter. Trust lubricates social life (Putman, 1993, p. 4). The above point was echoed by a 40 year old woman:

*“The advantage of working in this community is that, if I am short of money my uncle whom I borrow money from trusts that I will bring it back with interest in good time. There is no mistrust or feelings of superiority that one encounters from financial institutions in town” (Interviewed, 13 September 2008).*

The prevalence of “social capital” can also be attributed to the fact that access to financial services and insurance for poorer people has been undeveloped in South Africa (Skinner and Lund, 2003). The two scholars just cited here argue that compared to other African countries, South Africa has a well-established and resource-rich private financial and insurance industry however, does not offer financial services in the rural areas while in urban areas the poor are excluded through the eligibility criteria. For example, to open a bank account potential clients are often required to have a track record in a formal job. Furthermore, there are high minimum deposits and high charges for loans. The main reason given by eight of those interviewed for choosing trading as a profession was because they did not possess the skills needed for the jobs they wished to do. This finding is supported by Parnell et al (2000) citing Bhorate & Leibbrandt (1996), all pointing out that the unemployed are more likely to be poorly educated, unskilled and female.

It is important to note also that most of those interviewed had lost their jobs in the formal sector. However, a majority of the respondents believe that they did possess skills for other more permanent employment. The other important reason for choosing informal trading was that, entry was easier and investment requirements were low. As one female respondent (35-40) pointed out:

*“If it were up to me, I would be working in a government office somewhere in town instead of doing what I’m doing and having no certainty about my future and the future of my children. Government officials are paid a salary whether they perform their duties or not” (Interviewed, 11 September 2008).*

At the same time, working conditions of the traders were very difficult. The respondents revealed that they or their spouses leave their homes between four a.m. and five a.m. to collect their goods. After returning home for a short while, they start trading at six a.m. and in case their homes are close to their trading places they return at three p.m. to take care of domestic chores. They went back to their workplaces at five p.m. and returned home at nine or ten p.m. The distances travelled by traders to their workplace may be long. Almost 90 percent of the traders sell in areas close to their residences between one to four kilometers. They carry their wares in baskets on their heads or on pushcarts. Traveling to work differed based on where they were coming from. Generally, it took between five and ten minutes. This was due to the fact that most reside in Diepsloot where they also conduct business. However, about five percent said it took them about twenty minutes. On average, a trader had to work for 15 hours a day to earn their meager income. As one respondent put it:

*“The hours we spend in our businesses do not allow us to be effective parents, in that we leave before our kids wake-up and arrive home after they have gone to bed. The money we get is, sometimes, not enough to cater for all of our children’s needs. We assist government in creating jobs yet government does not cater for us. Government is only interested in those that are already rich and forcing white businesses to work with them, not poor people like us” (Interviewed, 11 September 2008).*

Some of the informal traders in Diepsloot employ people outside the family to help in their business. Their income is enough to permit them to employ others on small wages. Some traders especially those who own one or two Spaza shops, are supported by their wives and one or two of their children. The helpers do not sell wares but help with other activities. The family help

becomes necessary because the trader cannot do all the activities on his or her own. The low income from the trade makes it impossible to employ extra hands. What emerged from the research is that traders rely heavily on the social networks that exist within the community and within families. As noted by one respondent:

*“If it were not for my brothers and cousins, I would not be where I am. You cannot trust anyone here, they are my eyes and ears” (Interviewed, 11 September 2008).*

This suggests that there are already partnerships of some form that exist starting with the family and extending to the community. These networks are not considered in the current policy the Accelerated and Shared Growth Initiative for South Africa (AsgiSA), foresees further increases in growth rates to an average of six percent a year between 2010 and 2014 in order to achieve the objectives of halving unemployment and poverty. The formulation of AsgiSA was in many ways a courageous process as noted by Benard et al (2008). Although the government claims that it consulted widely with social partners and sought international expert opinion on this economic development policy, the focus was not on the informal sector and its growth, but on the shortage of skilled labour, high barriers to entry and low competition in some sectors of the economy.

#### **4.4.6 How many people are supported by the business**

On average, traders interviewed supported five people in their household, not including themselves. More than half supported between five and ten people and five respondents supported between one to five people. The highest number of people that one trader said she supported was thirteen people. The lowest number was two. This suggests that a large portion of their income goes back to the family, restricting investment and business growth. About four of the traders interviewed are putting their siblings and children through university. As a result, most of their children enjoy a better standard of living. However, this is not the norm. Nonetheless, it suggests that the business enabled most of the traders to move their families to Johannesburg from the rural areas. The back and forth links within families due to the informal business is remarkable.

The research found out that some of the food traders, the majority of whom are women, engage one or two helpers they pay monthly on top of providing them with meals. These traders employ

helpers to serve food, clean the utensils and deliver food to nearby offices at the Community Centre. The Community Centre (CC) resembles a city's business district because the CC houses a large number of Municipal and Developmental offices. These traders have higher income as there is a high demand for their products. The area has no restaurants and there are hardly any eating places. Traders selling cooked food supply not only offices but taxi drivers as well. The turnover for each trader is fairly high and their income is around R500 to R1000 per day, as compared to street traders who make on average R80 to R300 a day. This point suggests the need for support with regard to the provision of business infrastructure in these areas. One female respondent concurred with the above point by observing that:

*“The lack of proper infrastructure hinders our profits for example when it rains we cannot do our job. Our customers suffer as well because we cannot attend to them. Our businesses are impacted in a negative way, this results in loss of profit. The problem is that it is not only our businesses that are impacted, the community sufferers as well.” (Interviewed, September 2008).*

#### **4.4.7 Years trading and reasons for becoming a trader**

Generally, most of the traders interviewed have been trading for more than ten years, while a third has been trading for five years. The newest trader had been trading for one year since she lost her job as an office cleaner in town. The most experienced has been trading for over 30 years and has never known any other profession. The traders cited financial circumstances as a reason for starting, while three said they began trading once they lost their formal sector jobs. The lack of opportunities for employment led to most traders starting their own businesses. Lack of formal education was also cited as a reason for starting businesses. Longevity in the informal sector is clear evidence of lack of capital retention for growth. Some of these businesses merely address the symptoms of poverty and lack the ability to extricate themselves from the causes of poverty. One respondent vented his frustration by saying that:

*“Even though we would like our businesses to grow, everything is standing in our way. Government makes a lot of promises, but does not deliver and the formal businesses do not even engage with us. I have been doing the same thing for years, yet I really do not have anything to show for it. Everything comes and goes” (Interviewed, 10 September 2008).*

#### **4.4.8 Costs of Informal Self-Employment**

Chen (2005) argues while informal work does offer positive opportunities and benefits, the benefits are not sufficient and the costs are often too high for most of those who work informally to achieve an adequate standard of living over their working lives. This is apparent in the responses of the respondents above. Also, there are psychological and emotional costs in terms of a worker's self-esteem and dignity associated with many forms of informal work.

#### **4.4.9. Trader organisations**

Of all those interviewed, 40% said that they belonged to some type of trader organisation either as members of a street committee or one of the local trader organizations. Those who were not members claimed ignorance of the organisations or cited lack of interest. Some cited the lack of effectiveness of trader organizations as the cause of their lack of interest. This says a lot about the informal sector as a thriving industry and a diversified one. One male respondent pointed out that:

*“As much as we support these organizations there is nothing substantial that has been achieved, it is all talk and no results” (Interviewed, September 2008).*

#### **4.5 Number of Hours Traders Worked Per Day**

Nearly 50 percent of traders worked between 11 to 15 hours per day, while 41 percent worked from 5 to 10 hours and slightly more than 10 percent worked between 0 to 5 hours. The number of people that worked in the market was 68 percent and they worked between 11 to 15 hours. The majority of traders on the streets worked between 11 to 15 hours. Also, a substantial number of traders on the street said they worked between five and ten hours. The implications of the above results indicate that traders generally spend extremely long hours in their informal businesses with very little to show for it. The quality of jobs is also declining as permanent secure employment is replaced by precarious and vulnerable forms of employment.

On paper, workers have gained rights that in practice are being “hollowed out” as employers use various strategies to circumvent the labour law. At a micro-enterprise level, the promise of



democracy has been thwarted. The apartheid world order and discipline have been re-imposed in many South African workplaces, (Bezuidenhout and Fakier, 2006 cited in Cosatu Political discussion document). This is an issue that hangs over the head of the government to this day. One respondent pointed out that:

*“Even though we work long hours sometimes under very hush conditions, the most important thing is that we are able to put food on the table and our children get to go to school. These businesses enable us to have normal lives.” (Interviewed, September 13 2008)*

#### **4.6 Where Traders Buy Their Stock**

Most of the respondents purchase their stocks in City Deep, a wholesaler in town, which is 30 kilometers from Diepsloot. Some purchased their stock from China City or Cash and Carry in the Johannesburg city. However, one of the female respondents observes that the lack of interest from formal companies they deal with suggest a lack of regard for them:

*“The companies we buy our produce from are not interested in creating partnerships with us that would grow their businesses as well as ours at the same time. The challenges we have to go through in order to be able to afford some of the produce are not taken into account. They seem to forget that we come from poor communities. Also there is a lack of respect it is as if we are a nuisance to them” (Interview, 11 September 2008).*

Nanavity (2005) illustrates how the formal sector understands very little about informal economy workers, or low-income communities. She points out that the formal sector finds it difficult to move beyond self-interest to collective interest, as pointed out by the above mentioned respondent. The formal sector is characterized by short-term interests, high costs, and often wastefulness. The informal traders want a market share but with either the government or some other party creating the basic market structure. But this is no reason for not working with it. However, it has become quite clear to most respondents that there is lack of interest in forming partnerships between informal and formal businesses. As one male respondent put it:

*“It has taken government to establish some kind of link, to meet us halfway in our endeavors of establishing our businesses. Yet the people that benefit the most do not see the need” (Interview, 14 September 2009).*

One executive director of a blue chip company when interviewed on the subject of forming partnerships between informal and formal businesses commented:

*“As a company we are already very much involved with training of those that were previously disadvantaged as we are required by government. However, getting involved with helping to start up their businesses or help those already in business to grow their businesses is something we are not going to get involved in unless it makes economic sense for us. Already we are involved with training those without skills from disadvantaged communities as is required by government” (Interview, 10 September 2008).*

The respondent's statement supports the notion that there should be a radical policy that motivates corporate South Africa to form sustainable partnerships with informal businesses. The lack of compassion from formal businesses prompted the City of Johannesburg to come up with initiatives to help the fruit and vegetables traders. All the respondents who purchase their produce from town in Johannesburg cited the fact that they no longer have to travel long distances to buy their stock. The Johannesburg Fresh Produce Market now delivers fresh fruit and vegetables to their doorsteps. The mobile market is part of the Johannesburg Fresh Produce Market's (JFPM) strategy to bring fresh produce closer to communities, create jobs and develop small businesses. Generally, most of the respondents purchased their stock between once and twice a week and a slightly less number purchased between three or four times a week. When they purchased stock, more than half bought for more than R 1 500 worth of stock. Less than half bought for between R500 and R1000. The remainder bought for between R100 and R300. This benefits a few that are in this sector. A male respondent questions the rhetoric espoused by government in terms of fighting poverty by noting that:

*“If government was serious about fighting poverty they would come here where we trade and interact with us. Find out from us what our needs and challenges are and how as government they can meet us halfway in terms of improving the infrastructure and other important things” (Interviewed September 11, 2008).*

This insufficient support relates to Nanivity's (2005) argument that in the developing world informal businesses do not have access to current market information, and are therefore unable to be updated. This could also be attributed to a lack of education and being on the periphery of the city. Tools and equipment are old and outdated. There is hardly any investment in research and development that could upgrade production processes or develop new tools. As a result, workers in the informal economy are either kept out of the mainstream market or remain localized and become marginalised.

#### **4.7 How Much Profit do Traders Make Each Month**

More than half the traders that were interviewed had more than one or more businesses and as a result were able to take home more than R9500 per month. Others profited between R4000 and R7000. About two respondents profited between R2000 and R3000. Those that have construction and brick making reported much higher profits. However, they pointed out that those profits were only achieved when there is a demand for sub-contractors. The research reveals that traders that have businesses that are more survivalist in nature tend to make a lot less profit.

Most of the enterprises in the informal sector face the problem of capital and infrastructure facilities. They also face certain local problems like non availability of power, labour, raw materials and competition from larger enterprises and competition from larger units. The survey that was carried out by the Ministry of Labour (1997) revealed the following problems as the ones faced by the informal sector operators:

- Lack of funds
- Lack of space
- Licensing regulations
- Lack of demand for their products
- High cost of raw materials
- Lack of transport
- Eviction by force and theft (MOL,1997)

Skinner and Lund (2003) argue that it is inherently difficult in the informal sector to structure interaction between associations of workers and governance institutions. Most cities have few, if any, structured institutional spaces for continual interaction over decisions about, for example, the sites of new markets, priorities for development and participation in trade fairs. One hears of occasional, one-off initiatives, led by a charismatic official, to negotiate over a sensitive issue. Mostly, however, officials are unskilled in conflict resolution; there are no appeal mechanisms to settle disputes; and there is a high potential for violence to be used to address conflicts around property, assets, and trading spaces. The challenges faced by informal traders in Diepsloot were

clearly illustrated by two respondents. For instance, in relation to the challenges they face every day the first respondent said:

*“I started off with selling fat cookies to schools in the Diepsloot area. The business grew from there moved to trading informally on the streets of Diepsloot, trading in produce. The business grew and it allowed me to diversify into collection of used bottles and plastic goods. However, it was not easy in the beginning both myself and my wife had to work hard. When we first started in Alexandra all we could afford was to buy flour and oil” (11 September 2008).*

Similarly, the second respondent mentioned that their businesses also grew.

*“The challenges one faces can only be equaled by the joy of success. Today I own my own Taxi and been able to put all my children through school and some as far as university”(Interview, 11 September 2008).*

Most of the respondents were not pleased with the Local Municipality and the formal businesses operating in Diepsloot. They cite lack of consultation from the Municipality and point to corruption as the reason the Municipality is not engaging them. They trade in makeshift shelters that are not conducive to running a business. Right next to where they trade there is a problem of running sewerage which the Municipality is not doing anything about. They point out that the Municipality does not engage them even when there are opportunities for business. They allege that those opportunities are given to people who are not from Diepsloot. Whatever jobs may arise, the informal traders claim, are not sub-contracted to businesses in the area. They point out that the business community of Diepsloot does not benefit anything from the Municipality. They allege that the companies operating in Diepsloot work directly with the Municipality and none of the community organizations are involved in any of the meetings that engage the issue of economic participation. Fainstein (2000) argues that contemporary participatory processes at the city level are trying to actualize local democracy by transforming power relations to bring the previously excluded into decision-making process.

It is quite clear that in Diepsloot that is not the case, according to the respondents. They speak with such conviction and anger at the lack of progress in terms of engaging the community and addressing the challenges that face the community. Fainstein (2000) notes that city building for the benefit of non-elite groups requires empowering those who are excluded not just from discussions but from structural positions that allow them genuine influence. The ability to participate is one resource in the struggle for power, but it must be bolstered by other resources

including money, access to expertise, effective organization, and media coverage. The obstacles to involving citizens in metropolitan-wide planning, however, are enormous, and doing so means sacrificing the local familiarity that is the rationale for participatory neighborhood planning (Fainstein, 2005).

#### **4.8 How Do You See Big Established Businesses**

Regarding established businesses, all the respondents commented that they were not effective for their businesses. As one male respondent pointed out:

*“Diepsloot is situated next to the resources and work opportunities, for example people from this area are able to access various employment opportunities easily in the area as the settlement is surrounded by firms and affluent suburbs, and is near the city of Randburg”. However, big business does not see or relate to us on the same level, as long as we support them with the produce or materials we buy, they are happy”(Interview, 11 September 2008).*

Hemlin et al (2005) in their study on behalf of Planact observe that despite the fact that, an explosion of development in the north in the Johannesburg-Midrand- Tshwane corridor has led to very high land costs in areas in close proximity to Diepsloot such as Dainfern, Fourways and Midrand. A 2001 study by Planact in 2001 comments that Diepsloot is ideally located for job opportunities in those areas as well as Randburg and Sandton, making it a desirable location for settlement by the poor. The RSDF however indicates that the surrounding areas require skilled labour which would exclude most people in Diepsloot. Similarly, a female respondent commented:

*“The formal business community is difficult, not helpful at all; do not treat us as fellow business people with a desire to see our businesses grow” (Interview, 04 September 2008).*

Likewise another female respondent, aged between 21 and 25 said that,

*“even though we are known by those we buy from, there is no relationship that exists. They do not even extend credit to us traders even though they know that we buy on a regular basis. It is very difficult” (Interview, 12 September 2008).*

#### 4.9 Partnerships between Corporate South Africa and Informal Businesses

The respondents cited the lack of clear and sustainable links between corporate South Africa and the informal sector as the major cause of lack of growth and development in the area. Most respondents pointed out that the relationship that exists between big businesses and informal businesses in the area is from a very low base that only benefits Corporate South Africa. The only visible major corporations that are in the area are the major banks and the telecommunications companies. For instance, in relation to opportunities offered by the telecommunications companies one respondent said:

*“I am really struggling. It is like working backwards, there is no real profit in this business for us, and it is only them that are making a profit. I buy airtime for sixty five cent sell it for ninety five and make a profit of thirty cents. It is just a survivalist type of business I only keep it to cover basic needs in the house. I do not depend on it”(Interview, 13 September 2008).*

Other respondents mentioned that the close proximity of the Diepsloot Mall gives an impression that some kind of links exist with these formal businesses yet:

*“All they do is take businesses away from us. We were not even consulted about the building of the mall. Our businesses are suffering, they were quick to build the mall and yet we still have not been allocated proper business areas”(Interview, 13 September 2008).*

The general feeling amongst traders is that partnerships would be good for their businesses. However, those that have informal construction companies and brick-making companies feel that it would grow their businesses as one respondent put it:

*“I would be able to grow my business and employ more people, as I would be able to buy now and pay later, make a profit. Right now I am making no profit everything goes back into the business, it is like working backwards” (Interview, 13 September 2008).*

One female respondent who owns an informal construction company passed the following comment,

*“Partnerships with these companies would greatly benefit me as I would be able to sub-contract and work in areas that I am unable to access at this point”(Interview, 13 September 2008).*

Streeten (1991) discusses the scope for microenterprises to exploit the presence of formal sector firms to their advantage, or what he calls the “judo trick”. The new forms of production and work organization such as flexible specialisation emerging in many countries in recent years would seem to provide new opportunities in this direction. It seems equally important to forge complementary linkages between the informal and the formal sector firms through appropriate government policies and thus avoid situations where the two are in conflict. It may not be easy but possible.

#### **4.10 Conclusions**

Overall, traders in Diepsloot said they felt discouraged about the future. Not one informal trader interviewed said they were happy with trading and most complained about the lack of opportunities for advancement. It appeared that traders were at a loss for what to do in terms of how to improve their business and how to attract more customers. It was surprising that so many traders had savings accounts, but some people said there was “a hundred rand or two hundred rand” in the account. However, what is interesting is that even though they use the banks to save money, the banks will not lend them money. Even the respondents that own their own property cannot access funds from banks as the respondents are regarded as a risk. No one said they were a member of a stokvel, which was surprising because these appear to be popular savings schemes for most Africans.

The findings of this study seem to confirm the accessions made by De Seto (2002) that the Third World poor tend to possess de facto control over surprisingly large amounts of assets, such as houses, land, and small businesses. Yet, they find it difficult to use their possessions as collateral to borrow money to invest in starting small businesses. In South Africa, formal property rights is not the only, and far from the most important obstacle when, for instance, people living in informal settlements or townships apply for credit. Their lack of contacts, education, and language skills as observed in this study as well as the lack of documented and regular income often stand in their way even if property with formal titles can be used as security. Graner (2007) argues in his research on credit that developing countries shows lenders often demand securities valued several times higher than the sum of the loan.

In De Soto's rhetorical construction, the informal character of the economies becomes not only an explanation of why people live in poverty. Informal economy emerges more or less as synonymous with poverty. He argues that if the economic life of the poor could be incorporated into the rationally organized formal economy, their living conditions would improve rapidly. However, poverty does not actually arise from a lack of resources, but a lack of proof of ownership. In this way, the organization of property rights should not become the only relevant distinction between formal and informal. In De Soto's maxim, all other components are ignored or treated as nothing more than secondary effects which is problematic. The study revealed that the majority of people borrow more money not from financial institutions, but from informal businesses. Since more than half have savings accounts, it is evident that the majority of traders are knowledgeable about investment and the importance of not living from hand to mouth, no matter what their income is. Thirty-seven percent of traders acquired the funds to start the business from monies raised when they had jobs in the formal sector. What this means is that traders have the potential to manage their money and invest it wisely. However, they need the tools to apply this to their businesses. Evidence gleaned from the interviews reveals that they have not yet been able to improve their businesses because they lack these skills.

Chen (2007) argues that too many policymakers, formalization means that informal enterprises should obtain a license, register their accounts, and pay taxes. But to the self-employed, these represent the costs of entry into the formal economy. What informal traders would like is to receive the benefits of operating formally in return for paying these costs, including enforceable commercial contracts; legal ownership of their place of business and means of production; tax breaks and incentive packages to increase their competitiveness; membership in trade associations and statutory social protection. The issue of formalization is not, as indicated in the findings, a primary concern for informal traders. What traders want is the intervention of government in regulating the creation of sustainable partnership between informal and formal businesses.

Although this is not a large sample, the findings seem to correlate with the point made by Nwaka (2005) that the main policy challenge is how to support and regulate the urban informal sector in order to promote employment, productivity, and income for the poor, and at the same time ensure a safe, healthy and socially acceptable environment. Informal sector enterprises,



especially those located in residential areas, pose real health hazards for the urban community, particularly for the urban poor who can least afford the high cost of health care. The policy dilemma appears to be the containment of the adverse environmental impacts of many of the activities of the urban informal sector without disrupting livelihoods and causing social distress. The dilemma is also how to promote environmental awareness and guarantee the right to the city while at the same time protecting the vulnerable groups in the informal sector, especially women, children, and apprentices from harm and exploitation. These questions will be tackled in the following chapter

## **CHAPTER FIVE:**

### **CONCLUSIONS AND RECOMMENDATION: DEVELOPMENT POLICY FOR THE INFORMAL SECTOR**

#### **5.1 Introduction**

This chapter presents the main recommendations and conclusions of the study. The conclusions and recommendations are based on the key findings relating to the lack of partnerships between informal businesses and corporate South Africa. However primarily, the chapter will seek to address the key question of what is the best way to reconcile the ‘informal’ and the ‘formal’ sector so that the positive attributes of the informal sector and other non-formal institutions of civil society, can be harnessed and enlisted in the current campaign for good governance, poverty reduction, and economic recovery of places like Diepsloot. It will also look at the planning interventions to address the challenges in the area. In so doing, the chapter points out that what is needed is not less government, less control, or mindless deregulation of economic and planning activities. Rather, what is needed is a more enlightened, more participatory, and more equitable form of state intervention in order to eliminate needless restrictions and provide a more appropriate and flexible regulatory framework that is compatible with local conditions and yet reasonably efficient and environmentally sustainable.

#### **5.2 Challenges of Forming Partnerships**

This study has illustrated the challenges faced by informal traders and the lack of sustainable links between informal businesses operating in informal settlements and corporate South Africa. Extensive research conducted through interviews, confidential documents, media reports and studies about the sector has clearly indicated that what traders need the most is support. The study found that for many years now the Local Municipality tried to curb the activities of the informal traders in Diepsloot by zoning-off the areas they operate in for development without consulting them. Furthermore the perception amongst the traders has been that instead of promoting businesses that are based in Diepsloot, the municipality favours businesses that are not from the area. Despite claims that it wants to improve the informal sector, the collusion of

the municipality with the formal sector has, according to the traders tainted its intentions. The construction of the Diepsloot Mall is the case in point. The informal traders were not informed of the impending competition; the Mall as a result has impacted negatively on their businesses. They now have to compete with well established entities right on their doorstep leading to further under development. Under development is not necessary. Poverty leads to the under development of the individual. But the greater circumstances resulting from poor spatial planning entrench impediment to the growth of the informal sector and these impediments, enhance the vulnerability of the informal sector, thus the skewed relationships are re-enforced by public policy and planning.

Key observations emerging from this study indicate that several issues impede partnerships between the informal sector and the formal sector. The following are the most significant observations.

- Overall the research findings for this report serve to confirm and re-enforce a number of key features concerning the establishment and growth of sustainable businesses through the creation of partnerships with the formal sector.
  - The informal sector is unevenly developed and operationalised across Diepsloot.
  - Major divides exist between the largest and most well resourced and the smaller struggling street traders.
  - Local councilors have promised training to informal traders, but only those that are well resourced get the attention from councilors the rest of the traders are ignored.
  - It is ironic that the councilors whose positions derive from election by residents of informal settlements and derive from promises of improving their social and economic status, eventually their policies and practices, frustrate the development of the informal sector.
  - The lack of infrastructure is a huge challenge for the informal traders and local government seems incapable of addressing this challenge.
  - The way governments utilise space for developmental needs can embed detrimental circumstances to the growth of the informal sector.

- The constraint of the growth of the informal sector creates an economic separation of their viability and growth, thus creating dwindling economic opportunity against the general observation that informal settlements are high population growth points.
- It appears that the constraint of the economic growth of the informal sector through inappropriate public planning and policy seems to accelerate poverty because population growth in informal settlements is generally very high.
- Efforts to support the informal trade sector at establishing partnerships with the formal sector have been uncoordinated and disjointed.
- The informal construction companies that operate in Diepsloot get opportunities to work with formal construction companies only when these get tenders to do work in Diepsloot.
- Substantive partnerships are not created nor are they encouraged by the local municipality.
- Promises to engage the informal traders remain at a rhetorical level.
- Formal businesses display a clear lack of commitment when it comes to engaging with the informal sector in whatever form. They point to the lack of proper infrastructure to operate in the informal sector and the high levels of crime.
- The wealth creation of the potential of the informal sector entrepreneur is hamstrung ironically by the very public service he has put into office to make better the circumstances of the informal economy.
- Notwithstanding proposals by the national government to incorporate small businesses into the economy, this has so far not extended to the informal sector.
- Incorporating the informal sector into these proposals can help Diepsloot and other informal traders in other informal settlements and Townships enhance its economic base.

According to the research findings conducted with the 12 informal traders, most traders felt discouraged about their position in the Diepsloot landscape and their opportunities for advancement. Generally the feeling amongst the traders is that government makes all the right noises when it comes to creating opportunities for the disadvantaged and jobless, yet once those that are disadvantaged seek ways of bettering their circumstances government fails them. The government does not seem to take into consideration the fact that the informal sector offers an array of opportunities for people who have lost their jobs or have moved to Johannesburg seeking better opportunities. The provincial government needs to recognise that the informal sector will remain a vital and essential source of income for thousands of people across Johannesburg and millions across the country and therefore needs to develop a management plan that will enable them to have sustainable businesses through the creation of substantive partnerships with formal businesses. Formal businesses in South Africa were assisted by the apartheid government of the time using the oppressive labour laws and black people's tax money. Therefore this is the time to give back and mend bridges. The wealth they created was not due to their capabilities but through government interventions and forced black labour. However, the lack of commitment from formal businesses contributes to the challenges impeding the growth of the informal sector through the creation of partnerships. The following section will provide an overview of the above point.

The spatial structure and form of urban areas has a fundamental impact on the ability of small businesses to survive and grow. The term spatial structure refers to the configuration of public spaces and movement routes, their relationship to the distribution of population and to various land uses. Dewar and Watson (1991) argue that the structure has a major effect on the spatial pattern and intensity of economic activity. The manipulation of the urban spatial structure is therefore an important tool for influencing the number and performance of small operators. Dewar and Watson (1991) further argue that a characteristic of the South African city is its sprawling, with a low-density form. This form actively militates against small business activity and promotes economic centralisation. Land-use plans and building codes are often inadequate or too restrictive, leading to an increase in informal markets. Spatial development plans backed by a realistic regulatory framework could direct urban growth towards a sustainable environmental, social and economic development. In many cities the informal sector delivers most economic growth and is normally based in the unplanned areas (Eduards, 2006).

An initial set of microeconomic policy reforms was initiated after 1994. While they were successful in many cases, these reforms did not remove all the constraints to accelerated levels of growth in the economy. In spite of basic policy reform, the planning generally continues to be performed in the conventional top down approach, is centralised, comprehensive and controlling in nature. Watson (1991) argues that if a more facilitative policy towards the informal sector were adopted, it would be possible for a greater number of people to improve their survival chances or at least to supplement their income. The geographic position of Diepsloot informal settlement should be of great importance for the community, because it gives residents a better access to Midrand and Randburg, and the surrounding factories and industries. However, according to Baseline Survey (2001) percent of the population is unemployed. Informality becomes a refuge for those who cannot find employment in the formal sector.

The above point also raises the issue of capacity. Capacity building is a measure that requires the strengthening of the organisational and financial capacities of the informal sector operators in Diepsloot so that they can act for themselves in the long run. As their capacity is strengthened their voices will begin to be heard and when their voices are heard, there is no way they will be neglected by the government and not be included in the policy making and decisions that affect their operations and their lives.

It is a widely known fact that most developing countries created a bias in the policy framework in favour of the modern or formal sector. Such a bias naturally makes it more difficult for the informal sector to compete with its formal counterpart (Haggblade et al., 1990). In other words, the battle for economic space is not being fought on fair grounds. Streeten (1991) argues that the bias may be attributed to the belief held by governments, that modernization is synonymous with development and hence the formal sector needs to be promoted on a priority basis, or it may have been guided by other considerations such as the substitution of imports. It is also perhaps true that few governments believed that the informal sector is capable of contributing to national output. This may be attributed to insufficient awareness and information on this sector.

There indeed seemed to be consensus among the respondents regarding big business and the lack of sustainable links that informal traders can benefit from. It has emerged from the research that the informal sector is never going to expand its market share at the current rate, driven by the

lack of efficient policies. Analysts suggest that the informal economy is large enough to permit, and diverse enough to necessitate a wide range of different policy measures, allowing government to mix incentives, assistance, neglect, rehabilitation and persecution within the total range of policies (Nakwa 2005).

Thus, even though policies are not specifically designed for the informal sector, they can nevertheless have a negative effect on it. They can not only limit their participation and constrain their response to opportunities for expansion but also distort the incentive structures e.g. by lowering returns to investment they can discourage expansion. Sathuraman (1998) argues that in addition to the policies mentioned above, one should note that the State often plays a direct role in the allocation of resources in many developing countries. Allocation of certain key raw materials or inputs under state control may be biased, based on predetermined price and quantity and certain production facilities or markets may be reserved for certain types of firms. Though there are no serious studies analyzing the quantitative impact of various policy distortions on employment and incomes in the informal sector, most evidence seems to suggest that unfavourable policies can not only depress current incomes but also future growth potential (Sathuruman 1998, Streeten 1991).

The telecommunications and banking sector appear to have created some links between the formal and informal businesses. However, the results of the research suggest that these links are exploitative and unsustainable. Instead of contributing to the development of the community, they are economically unsound for the marginal business. Dewar and Watson (1991) argue that the informal sector is incapable of significant accumulation because its level of surplus is dictated by the accumulation process in the formal sector, that is, linkages are exploitative. The lack of interest from corporate South Africa to get involved in these areas is clearly evident. They point out that they will only get involved if it makes economic sense for them.

Current interventions in favour of the informal sector have tended to ignore the complementarity between resources such as credit, skills, etc. and other inputs. Evidence suggests that infrastructure plays a huge role in raising the incomes of microenterprises, particularly in the large cities. Often big business cited the lack of infrastructure as one of the reasons for their lack of interest. Sethuraman (1998) argues that unless the physical environment is conducive the

supply-side interventions currently being pursued yield only limited results. This is because physical location and access to proper premises, both closely related to legal recognition, determine the income prospects and opportunities for investment. Efforts to support the informal sector through the creation of sustainable links between informal and formal businesses have been uncoordinated.

The researcher's analysis of the role of the informal sector and the lack of partnerships in Diepsloot clearly supports the views that any effective strategies for development or poverty alleviation have to develop and implement policies that aim at enhancing the socio economic environment of the informal sector. Lack of access to adequate financial services in the informal sector is one of the major problems that needs to be addressed by the developmental agendas proposed by policymakers in South Africa.

The examination of the lack of a role of corporate South Africa in the mobilization and allocation of resources to the entrepreneurial activities of the economic agents in the informal sector reveals that around 80 percent of the small economic agents in a typical developing economy are unable to make use of the benefits that would come with that kind of partnership. It further reveals that the informal linkages that assume this function in Diepsloot are limited in their capability to provide such services in the form that would result in a significant contribution to development and poverty reduction. Subsidized credit from within the community was also seen to have limitations in terms of continuity and in terms of reaching its intended targets due to a variety of reasons.

There is a large demand for some form of intervention in the informal sectors and among the poor. The in-depth analysis of the linkages as a tool for development demonstrates that it has obvious advantages over the alternative options of financial services available to the lower income agents. It is not alien to the informal sector as many of its techniques are based on social capital. It is not limited by community borders and serves a larger and more diversified customer base. Access to credit on a long term basis is more important than cheap credit. If it is based on the financial intermediation approach, microfinance can be sustainable, particularly if it functions in an adequately regulated environment.



The researcher's analysis of the demand and supply of microfinance services reveals the existence of a large gap which is attributed to a number of factors including the very large demand, the lack of basic infrastructure, and the lack of information which until recently slowed down the growth of the informal industry. This however, is changing. The information revolution is contributing to the spread of microfinance and the industry has witnessed significant development in the past decade. One can envisage that meeting the demand for microfinance would have significant positive socio economic effects that would result in improving the economic conditions and enhancing the social status of the lower-economic agents.

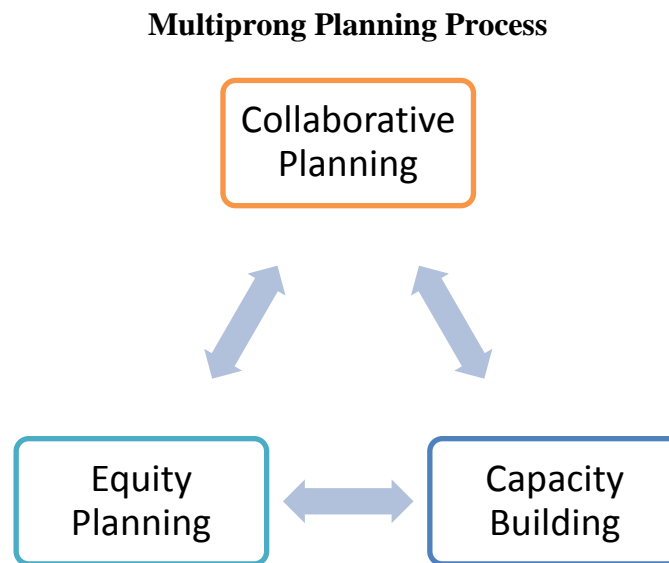
### **5.3 Strategic Interventions**

The informal economy makes a significant contribution to the economic development of Diepsloot. The local municipality has committed to developing and supporting the sector but current policies have failed to obtain the desired results.

It is important that the policy encourages the preparation of local and metropolitan development plans, which integrate investments and their spatial implications, and need a suitable plan making mechanism and techniques. Jain (2001) points out that this requires serious consideration so that the planning framework responds to the climate of new economic policies and democratic decentralisation. In order to enable the implementation of the new strategy, it would be necessary to restructure town planning departments, development authorities and the local bodies and to equip them for the new policy changes. The challenge is to evolve a decentralised, localised planning structure with public-private partnership approaches.

This research proposes a multi-pronged process of dealing with the challenges. It suggests that these challenges can be dealt with through collaborative planning, equity planning as well as capacity building initiatives.

Figure 5.1: Multipronged Planning Process



#### 5.4 Collaborative Planning

Healey (1997) suggests that the potential synergies between established and emerging stakeholder interests can only be reaped through open debate (and *not* through big-bang mediation) because the meaning of place can only become *shared* if it is dialogically constructed and articulated. Healey (1997) argues “assume that planning processes should be interactive and that they will involve many of those with a stake in locations. Effective collaborative planning generates “strategic conviction”, it is aware of the market’s proneness to failure and it takes social and environmental costs into account. Among the outcomes of collaborative planning are, again, criteria to be used in regulating land and property development rights but these criteria are not abstract but locally specific, formulated in a locally specific language and grounded in locally specific rationales.

In the case of Diepsloot, collaborators could be constituted by drawing from stake holders. These would mainly be public sector actors, and some are mixed public and private. Some could focus on developing a shared vision, some work on solving particular problems such as traffic congestion or worker training, and some try to develop collaborative policy that cuts across agencies and gets the support of stakeholders who would otherwise oppose it. These stakeholders

would be hawker associations, family representatives, churches and funeral associations. These are people that can sit in a hall and engage in collaborative planning. Corporate South Africa could get involved if funding agencies like Khula and Msobomvu are present. These stakeholders are divided into four types: civic organizations, government departments for example Department of Trade and Industry, Department of Transport and Department of Public Works. All of these departments would be expected to deliver their line functions in a co-ordinated manner and also in agreement with the community.

The key attribute of collaborative planning is that even those that involve public agencies and public funding operate in an ad hoc way outside of formal government and without regulation or governmental mandate. They are self-organizing, created in a variety of ways, maintained by a wide variety of funding sources, including not only government, but also foundations and self-funding by those stakeholders with sufficient resources. Sometimes they lobby public agencies and legislators for formal changes in laws and procedures. Sometimes they simply take action as a group or individuals to implement shared goals. They may raise funds, organise and do public education, or implement programs that do not require government action, such as an investment fund for poor neighborhoods. If they include public agencies, the agencies themselves may voluntarily make changes in how they operate as a result of discussions. In some sense, these collaborative processes are doing what we might have expected government to do and they are filling in a gap in the governance, particularly of regions, where in the local government there is typically a vacuum of power and responsibility.

However, the core function of the objective for engaging in collaborative planning in Diepsloot would be the formation of partnerships between corporate South Africa and the informal businesses that operate there. The partnerships could be through training of informal business operators, adoption of informal businesses and injection of funds. Collaborative planning would enable collaborators to deal with some of the questions that the researcher raises in the proposal. The question of what roles Provincial and Local government is playing in facilitating the development of sustainable partnerships.

Amin and Thrift (1995) argue that the linked notion of institutional thickness refers to a set of factors including a strong institutional presence; a high level of interaction amongst local

networks of institution and shared cultural norms and values. Together, these factors encourage the development of trust and co-operation which seems to be critical to the stimulation of entrepreneurship and economic development. McCarthy and Lloyd (2007) point out that the notion of institutional thickness is important in understanding and informing the efforts of local governing regimes to develop their local economies in an endogenous manner.

However, Flyvbjerg (1998) points out that power determines what counts as knowledge, what kind of interpretation attains authority as the dominant interpretation. Power procures the knowledge which supports its purpose, while it ignores or suppresses that knowledge which does not serve it. Moreover, the relations between knowledge and power are decisive if one seeks to understand the kinds of processes affecting the dynamics of politics, administration, and planning. This process of collaborative planning should be accompanied by equity planning as Krumholz and Clavel (1994) observe that equity planning is not simply focused on the equitable *outcomes* for development income redistribution or poverty alleviation but also on empowering disadvantaged groups to take part in decision making processes. The role of equity planning in providing technical assistance and democratizing urban economic development projects is also key.

### **5.5 Equitable Planning**

The Equity Planning model is an example of planning that is by informed public action. Lester (2004) argues that it is an excellent example of linking theory and practice. Specifically, equity planning is intended to redistribute power and material wealth away from the “business elites that frequently benefit from public policy and towards the needs of low income or working class people” in large central cities (Krumholz and Clavel, 1994).

Effective equity planning seeks to ensure that there is empowering of disadvantaged groups to take part in decision making processes. In order to support places like Diepsloot, the role of equity planning should be able to do the following:

- develop a more robust policy,
- provide technical assistance,
- democratize urban economic development projects,

- target a distinct spatial focus for economic development and set informal settlements as budgetary priorities. It is generally agreed that spatial planning has only had a limited effect on post-apartheid urban spatial development (Watson 2002).

The focus in Diepsloot should be on area based planning. Anderson (2001) argues that it sometimes can be relevant to have efforts concentrated in deprived urban areas for two reasons. Firstly, to combat special effects produced by area deprivation that tend to increase the economic development of the whole of Johannesburg. The area-based approach means taking places seriously and addressing the issues they face in the round, i.e. ‘joined-up’ or integrated policy-making. In some places this has extended the scope of activity to transport, environment and economic development issues. These have a direct effect on local employment opportunities and on people’s access to them (Turok, 2001). The city has committed itself to developing social exclusion.

The informal economy makes a significant contribution to and supporting the sector, but current policies have failed to obtain the desired results. There is no formal policy that comprehensively guides the management and support of traders in the formal economy. Chen (2007) states that given the informal economy is here to stay, and that the informal and formal economies are intrinsically linked, what is needed is an appropriate policy response that promotes more equitable linkages between the informal and formal economies and that balances the relative costs and benefits of working formally and informally. While the focus here is on the role of government, there is a role for all stakeholders, including formal firms in promoting socially responsible corporate practices as well as organizations of informal workers in policy making.

Some analysts suggest that the informal economy is large enough to permit, and diverse enough to necessitate a wide range of different policy measures, allowing government to mix incentives, assistance, neglect, rehabilitation and persecution within the total range of policies. It is important to stimulate the informal sector, despite the existence of a potentially exploitative relationship between certain forms of commercial enterprises.

Government needs to implement policies that address the issue of informality in South Africa taking into account South Africa's apartheid past. Essentially, the country needs a policy that addresses the serious issue of lack of notable growth in this sector, a policy that will force big business to engage, create links between formal and informal business and support these informal businesses. Watson and Dewar (1991) concur with the above point by illustrating that if a more facilitative policy towards the informal sector were adopted, it would be possible for a greater number of people to improve their survival chances, or at least to supplement their incomes. They point out that similarly, it is sensible to introduce policies which strengthen the relative position of economic concerns at the lowest end of the continuum of economic activity in a proscriptive and not a prescriptive way. A particular advantage of strategies aimed at stimulating informal sector activities is that they not only contribute to employment creation, but are a direct attack on poverty.

There remains an urgent need for genuine decentralization to open up more political space at the local level and encourage more broad-based participation, accountability, inclusiveness, and social sustainability. Local governments are on the front line, and should be given greater authority, discretion, and enhanced capacity to mobilize support and resources, taking everybody's needs and views into account in formulating and implementing development policies and programs. To play their role more effectively, local governments need improved technical, administrative, and financial capacity through genuine decentralization and increased support from national and international development agencies, including non-governmental organizations (NGOs) (Nwaka 2005).

Evidence suggests that infrastructure (notably land and business premises) play a critical role in raising the incomes of microenterprises, particularly in the large cities. Unless the physical environment is conducive the supply-side interventions currently being pursued yield only limited results (Sethuraman, 1997). This is because physical location and access to proper premises, both closely related to legal recognition, determine the income prospects and opportunities for investment. The above point is important in that with regard to Diepsloot the area where the traders operate has been neglected. Failure to recognize these inter-relationships has contributed to marginalization of the sector in both economic and physical terms. The issue

therefore is how to prevent its marginalization, and ensure its integration into mainstream development.

Sethuruman (1997) argues that if the interventions in support of this sector are to achieve sustainable results then they must go beyond partial solutions. A serious effort must be made to physically integrate the units in this sector by recognizing the existence of this sector and adapting the city plans as necessary. This would call for significant departures from the conventional approaches to city and urban regional planning. It would involve trade-off between efficiency and equity since allocation of space for the informal sector in inner cities (where informal producers and traders realize higher incomes owing to a variety of linkages) could mean less efficient use of land but would result in improved incomes for the poor. Besides making land accessible the urban authorities must consider improving the urban infrastructure and making them accessible to micro producers. Implementing these ideas would however call for appropriate changes in certain legislations (e.g. land ownership and tenure), in the land use planning, in pricing of infrastructure related services etc.

However, Lester (2004) suggests that it is important to point out that political economists' analyses of urban and regional development seeks to answer the questions as noted by Fainstein (2000) of "Who dominates?" and "Who benefits?" Although bringing to light glaring abuses of power and patterns of uneven development across groups (e.g. gender, race, neighborhoods) implies an emphasis on equity as the goal of ameliorative action, most political economists fall short of presenting a fully articulated vision of a "just-city." Researchers in this paradigm advocate an economy that benefits more than the wealthy. Their recommendations call upon the state and or civil society to rein in the abuses of capitalist development through regulation and the creation of social markets. Yet, even here the arguments of political economists fall short of explaining why society should value greater equality. Fainstein (2000) offers the closest definition to date:

*For just-city theorists, it [utopian vision/normative vision] concerns the development of an urban vision that also involves material well-being but that relies on a more pluralistic, cooperative, and decentralized form of welfare provision than the state-centered model of bureaucratic welfare state. (Fainstein, 2000 p. 473)*

Although aspects of this vision are akin to what Krumholz and Mier practiced, particularly the focus on “pluralistic” and “decentralized” policy making, we must turn to political and moral philosophy for a complete normative justification for the “just-city”.

John Rawls’s (1997) theory of *Justice as Fairness* offers planners a clear model for action. Through careful and rational analysis, Rawls provides a justification for policies that promote redistribution of resources toward the disadvantaged. For Rawls, a truly just society is one in which there is near total equality of rights as well as material goods. This is often understood as a justification for income redistribution as a *means* of promoting equality.

However another modern philosopher, Amartya Sen (1999) extends Rawls’ (1997) ideas. Sen widens the goal of equitable development from a narrow focus on income inequality and the distribution of real resources, towards a focus on the ends these resources enable. Sen’s (1999) definition of economic development is similar to that of Krumholz (1994) and Mier (1993) and offers additional elements that help reground contemporary calls for addressing inequality. Instead of calling for an even distribution of material goods across people or nations, Sen (1997) argues that development should focus on expanding human capabilities, such as the capability to be nourished, secure and lead a life free of disease. Sen’s (1997) “human capability” approach stems from classical philosophical discussions of human nature or, in other words, what is essentially “good” for man. The above point will be discussed in detail in the next paragraph.

## **5.6 Capacity Building**

The challenges facing informal traders are multi-faceted in that the lack of capacity in the local municipality is a huge contributing factor. The lack of capacity combined with their own limitations contributes to the lack of progress. Sen (1980) in his capability approach sees human life as a set of “doings and beings” we may call “functionings” and it relates the evaluation of the quality of life to the assessment of the capability to function. He points out that capability reflects a person’s freedom to choose between different ways of living

Fakuda-Parr (2002) points out that Sen’s theory of development as capabilities expansion is a starting point for Human Development Approach (HAD). The idea that the purpose of development is to improve human lives, and that meant expanding the range of things that a person could be and do (functionings and capabilities to function, such as to be healthy and well



nourished, to be knowledgeable, to participate in the life of a community.) From this point of view, development is about removing the obstacles to the things that a person can do in life, such as illiteracy, ill health, lack of access to resources, or lack of civil and political freedoms.

It is important to emphasize that the Human Development (HD) perspective contains two central theses about people and development, and to distinguish between them. They are what Sen (2002) calls the '*evaluative aspect*' and '*the agency aspect*'. The first is concerned with improving human lives as an explicit development objective, and with understanding possible ways of improvement. The second is concerned with what human beings can do to achieve such improvements, particularly through policy and political changes. The human development approach is commonly associated with the evaluative aspect, but the agency aspect is less widely appreciated.

It is important to note economic liberalization and political democratisation are the dominant influences for most countries. This shifts priorities for human development. Capabilities to participate and collective agency of social action have become more important. Against economic entrepreneurship that drives markets, social entrepreneurship is expected to drive policy debates on issues that matter for people's well being and human development. Collective action by people, and actors other than the state, notably civil society groups, now plays a larger role in shaping the course of development. There is an emerging consensus on the importance of civil society as actors in promotion of development.

Within the Capability Approach (CA), economic, political, legal and other social arrangements are evaluated according to how they expand people's capabilities or their ability to achieve the things they have reason to value. The Capability Approach views people as participants and agents of development. It takes into account the diversity of values across individuals and groups. Furthermore, CA helps make researchers and other stakeholders aware of group disparities (such as those based on gender, class, race, ethnicity, sexual preference and others), and capability disparities that exist between communities and nations.

## 5.7 Conclusion

The informal economy in South Africa plays an important role in the overall economy, both as a result of its size and because of its exploitative relationships with the formal economy. Macroeconomic policy which ignores or neglects the inclusion of the informal economy in its modeling and planning faces the possibility that its policies may be overly contractionary or that they have unintended consequences. The informal economy should therefore be included in all macroeconomic models, be they monetary, fiscal, or development models. In South Africa the inclusion of the informal economy takes on even further significance in that the informal economy consists largely of the formerly disadvantaged. The disadvantaged people of South Africa of all races in particular black Africans are the people who are meant to be given priority in terms of the government's broad macroeconomic policy.

Sathuraman (1997) points out that a majority of the poor are found in the informal sector. There are unmistakable signs that the pressure on this sector to absorb more labour will increase in the future. Such increase in employment is unlikely to be accompanied by increase in incomes unless drastic action is taken soon. In other words, there is every likelihood that urban poverty will rise in developing countries. However, the accumulating experience and knowledge suggest that it is possible to make the process more efficient and equitable. But it would imply surmounting a number of challenges including reforms in policies, regulations and institutions, leading to the integration of the sector with the mainstream development eventually. They are unlikely to come unless those in the informal sector organize themselves and exert pressure on the authorities and big business concerned. The prospects for reducing urban poverty in developing countries also depends critically on their overall economic performance for without adequate economic growth, development in the informal sector will only be involutionary. The above point illustrates clearly the argument that the creation of partnerships between corporate South Africa and the informal sector would benefit the country.

It is critical that local governments initiate defined monitoring and evaluation programmes to gauge the success of their initiatives. This should be based on both financial criteria and social impact assessment. Initially there may need to be experimentation to develop ideal methodologies. Over and above the use of data collected by municipalities, use should also be

made of data from government household surveys to assess the nature of local economic changes. There is still far too much competition between levels of government including local and district municipalities, and between these municipalities and provinces. There is inadequate involvement of the private sector, with severe implications in terms of duplication and lack of synergy.

Partnership formation and growth coalitions need to be encouraged and the private sector in particular, where it exists in significant strength, needs to be encouraged to contribute more meaningfully to local development, through the creation of partnerships with the informal sector. The private, community, NGO sectors all have key roles to play. They should be supported and encouraged to engage in collaborative and independent action, a clear case can be argued for a new development fund which targets support to economically sustainable informal businesses.

The current trade-off of economic investment in the formal sector, and pro-previously disadvantaged investment in basic services, is not likely to yield the improved livelihoods in the informal sector which will transform the lives of the poor. Indeed in some respects other countries of Africa, while poorer, have a better balance in these, which promotes greater self-reliance, and lessens dependency of the poor.

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## Appendix 1

### Questionnaire for Informal Traders in Diepsloot

The following are questions about your personal and business life. The information will be used for a research report in compliance of a Master's degree in Development Planning at the University of Witwatersrand. The results will be used for educational purposes only.

#### Personal Questions (Please check one)

- 1) Gender Male\_\_\_\_\_ Female\_\_\_\_\_
- 2) Age 18-25\_\_\_\_\_ 25-30 \_\_\_\_\_ 30-35\_\_\_\_\_ 35-45\_\_\_\_\_ 45-55\_\_\_\_\_
- 3) Education Level Primary\_\_\_\_\_ Secondary\_\_\_\_\_ Matric\_\_\_\_\_ Varsity\_\_\_\_\_
- 4) Where are you from originally? Johannesburg\_\_\_\_\_ Rural Area\_\_\_\_\_ Another city in South Africa\_\_\_\_\_ Another Country\_\_\_\_\_
- 5) How long have you been trading? 0-5 years\_\_\_\_\_ 5-10 years\_\_\_\_\_ 10-20years\_\_\_\_\_ Over 20 years\_\_\_\_\_
- 6) Why did you become a trader? Financial Reasons\_\_\_\_\_ Lost job in formal sector\_\_\_\_\_ Saw an opportunity to start a business\_\_\_\_\_ No education\_\_\_\_\_ Other\_\_\_\_\_
- 7) How many people do you support? \_\_\_\_\_
- 8) How much is your rent? R100-250\_\_\_\_\_ R251-500\_\_\_\_\_ R501-750\_\_\_\_\_ R751-1000\_\_\_\_\_ More than R1000\_\_\_\_\_
- 9) How far do you have to travel to your trading spot? 0-10 minutes\_\_\_\_\_ 10-20minutes\_\_\_\_\_ 20-30 minutes\_\_\_\_\_ 30-60 minutes\_\_\_\_\_ More\_\_\_\_\_
- 10) Do you have medical aid? Yes\_\_\_\_\_ No\_\_\_\_\_
- 11) Do you have a funeral plan? Yes\_\_\_\_\_ No\_\_\_\_\_

#### Business Question (Please check one)

- 12) What do you trade? Produce\_\_\_\_\_ clothes\_\_\_\_\_ personal beauty \_\_\_\_\_ electronics\_\_\_\_\_ other\_\_\_\_\_
- 13) Why do you trade in an informal capacity?

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14) Who are your regular customers?

15) Where do you buy your supplies?

16) How do you see the big established businesses ?

17) Do you believe that forming partnerships with these businesses will benefit you?

18) How did you start your business? Raised money \_\_\_\_\_ Borrowed money from friends \_\_\_\_\_  
Borrowed money from family \_\_\_\_\_ Other \_\_\_\_\_

19) How much did it cost to start your business? R0-50 \_\_\_\_\_ R51-R100 \_\_\_\_\_  
R101-250 \_\_\_\_\_

R251-500 \_\_\_\_\_ R500-750 \_\_\_\_\_ R751-1000 \_\_\_\_\_ More than a  
R1000 \_\_\_\_\_

20) Is government helping business in this are at all? Yes \_\_\_\_\_ No \_\_\_\_\_

21) If they are how has that benefitted your business?

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22) How many hours do you work per day? 0-5 \_\_\_\_\_ 5-10 \_\_\_\_\_ 10-15 \_\_\_\_\_  
More \_\_\_\_\_

23) Do you have a savings account? Yes \_\_\_\_\_ No \_\_\_\_\_

24) If yes, where? Bank \_\_\_\_\_ Stokveld \_\_\_\_\_ Other \_\_\_\_\_

25) Is this your only business? Yes \_\_\_\_\_ No \_\_\_\_\_

26) Do you know about business classes provided by the city? Yes \_\_\_\_\_ No \_\_\_\_\_

27) Would you be interested in taking free classes about business? Yes \_\_\_\_\_ No \_\_\_\_\_

28) What kind of business help do you need? Financial \_\_\_\_\_ Management \_\_\_\_\_  
Item Selection \_\_\_\_\_ Publicity \_\_\_\_\_ Other \_\_\_\_\_

### Planning Factors

29) How is the relationship between business and the municipality?

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30) Who allocated the site to you?

31) Do you pay anything for the place? Yes\_\_\_\_\_ No\_\_\_\_

32) Is the City council and local government helpful to you and your business?

33) How has the current development planning of your area benefitted your business?

34) What role do you see local planning undertaking now and in the future concerning your business and in the informal sector at large?

Thank you!