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## Tackling the hidden enterprise culture: Government policies to support the formalization of informal entrepreneurship

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It is now recognized that many entrepreneurs operate wholly or partially in the informal economy. Harnessing this hidden enterprise culture by facilitating its formalization is therefore a potentially effective and innovative means of promoting economic development and growth. To start evaluating how this might be achieved, the aim of this paper is to understand entrepreneurs' motives for operating in the informal economy so as to identify the public policy interventions required to facilitate the formalization of this hidden enterprise culture. Reporting a survey of 51 nascent entrepreneurs in North Nottinghamshire, of which 43 were operating in the informal economy, the finding is that entrepreneurs' rationales for working informally differ according to both whether they operate wholly in the informal economy or have registered enterprises but trade partially off-the-books, as well as whether they view themselves as on a journey towards formalization or not. Different policy measures are therefore required to tackle each type of informal entrepreneurship. The outcome is a tentative call for a more nuanced and bespoke policy approach for tackling the different kinds of informal entrepreneurship that comprise the hidden enterprise culture.

**Keywords:** informal sector; enterprise development; enterprise culture; entrepreneurs; shadow economy; undeclared work

### 1. Introduction

It is now widely recognized not only that the informal sector is large and growing across the globe (ILO 2002a, 2002b; Schneider 2008; Charmes 2009; Jütting and Laiglesia 2009), but also that many entrepreneurs trade wholly or partially in the informal economy (Williams 2006). Developing government policies to formalize these informal entrepreneurs could therefore be an innovative and effective means of promoting economic development and growth in many populations. This recognition is the starting point of this paper. The aim is to evaluate entrepreneurs' motives for operating in the informal economy in order to understand the public policy interventions required to legitimize this hidden enterprise culture.

To achieve this, first a brief review will be undertaken of what is known about informal entrepreneurship revealing that few, if any, studies have evaluated entrepreneurs' rationales for operating in the informal economy and therefore identified the barriers that governments must overcome to facilitate formalization, the Section 3 will then document the methodology used to study this in a

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North Nottinghamshire locality whilst Section 4 will report the findings. Finding that their rationales for operating in the informal economy vary across different segments of the hidden enterprise culture, Section 5 will then identify how government policies for tackling informal entrepreneurship need to be tailored to deal with the contrasting barriers to formalization faced by different kinds of informal entrepreneur. Section 6 will then draw out some very tentative conclusions regarding the bespoke policy approaches required for each type of informal entrepreneur and make a call for further research to evaluate whether entrepreneurs' motives and the policy interventions required are similar or not in different populations.

Before commencing, however, a clear definition of informal entrepreneurship is required. Here, and given that entrepreneurship 'means different things to different people' (Anderson and Starnawska 2008, 222), a working definition is adopted appropriate to the task at hand but which may not be universally applicable. For the purposes of this paper, an entrepreneur is defined as somebody actively involved in starting a business or is the owner/manager of a business that is less than 36 months old (Reynolds et al. 2002; Harding et al. 2006). Meanwhile, although some 45 different nouns and 10 adjectives have been used to denote the 'informal economy', such as 'cash-in-hand', 'shadow', 'informal', 'black' and 'underground' economy/sector/work, the widespread view is that the informal economy should be delineated in terms of what is absent from, or insufficient about, it compared with the formal economy. The strong consensus is that the only absence from, or insufficiency about, the informal economy is that the remunerated production and/or sale of licit goods and services is not declared to the authorities for tax, social security and/or labour law purposes when it should be declared (OECD 2002; Williams 2006; European Commission 2007). Consequently, an informal entrepreneur is here defined as somebody starting a business or are the owner/manager of a business that is less than 36 months old who engages in the remunerated production and/or sale of licit goods and services that are not declared to the state for tax, benefit and/or labour law purposes when they should be declared.

## **2. What is known about the hidden enterprise culture?**

Since the turn of the millennium, it has been recognized that the informal economy is not some minor practice that only exists in a few marginal populations. Of a global working population of some three billion, nearly two-thirds (1.8 billion) work in the informal economy (Jütting and Laiglesia 2009). The majority in this informal sphere work on a self-employed basis: 70% in sub-Saharan Africa, 62% in North Africa, 60% in Latin America and 59% in Asia (ILO 2002b) and 77% in the European Union (Williams and Windebank 2011). This suggests that a large proportion of entrepreneurs might operate in the informal economy. Reviewing the burgeoning literature on entrepreneurship, however, this has been seldom evaluated. As Williams (2006) and Jones and Spicer (2006) claim, this is because entrepreneurship as a discipline remains dominated by a wholesome, positive and virtuous representation of the entrepreneur as a super-hero (Cannon 1991; Burns 2001; Williams 2009). The outcome is that forms of entrepreneurship tarnishing this ideal have been positioned either outside the boundaries of entrepreneurship, ignored, portrayed as temporary or asserted to have little to do with 'proper' entrepreneurship.

Nevertheless, since the turn of the millennium, this ideal-type depiction of the entrepreneur as an object of desire has started to be transcended. Grounded in a critical realist approach, a small emergent sub-set of the entrepreneurship literature has built upon an earlier body of work on the negative attributes of entrepreneurs and how entrepreneurs do not always play by the rulebook (Collins, Moore, and Unwalla 1964; Kets de Vries 1977). On the one hand, a literature on criminal entrepreneurship has begun to document the illegitimate acts conducted by entrepreneurs (Fournier 1998; Deutschmann 2001; Friman 2001; Rehn and Taalas 2004; Armstrong 2005; Jones and Spicer 2005, 2006; Sköld and Rehn 2007; Smith 2007; Storr and Butkevich 2007; Frith and McElwee 2008; Bouchard and Dion 2009; Smith and Christou 2009; Gottschalk and Smith 2011) as well as how those pursuing illegitimate practices, such as criminal organizations, drug dealers, prostitutes and pimps, often display entrepreneurial traits (Friman 2001; Frith and McElwee 2008; Bouchard and Dion 2009; Smith and Christou 2009; Gottschalk 2010).

On the other hand, and beyond this entrepreneurship literature on the provision of illegitimate goods and services, a further literature has begun to explore informal entrepreneurship where the only illicit aspect is that the remuneration is not declared to the public authorities when it should be declared (Valenzuela 2001; Arrowsmith et al. 2003; Rehn and Taalas 2004; Small Business Council 2004; Venkatesh 2006; Williams 2006, 2009; Llanes and Barbour 2007; Ram, Edwards, and Jones 2007; Anatonopoulos and Mitra 2009; Webb et al. 2009; Gurtoo and Williams 2009; Bureau and Fendt 2011). This emergent literature suggests that a large proportion of entrepreneurs conduct some or all of their transactions in the informal economy (Rehn and Taalas 2004; Small Business Council 2004; Williams 2006, 2009; Llanes and Barbour 2007; Anatonopoulos and Mitra 2009).

Until now, however, few have estimated the proportion of entrepreneurs operating informally. One of the few studies to estimate this discovers that 100%, 90% and 77% of entrepreneurs interviewed in Russia, Ukraine and England, respectively, operate informally (Williams 2009). Although based on a survey of just 81 entrepreneurs in Russia, 331 in Ukraine and 91 in England, the strong intimation is that the vast bulk of entrepreneurs operate informally in all three countries. Moreover, this tendency is more prevalent in some locality-types than others. As Williams (2010) finds in English localities, entrepreneurs are more likely not only to operate informally, but also wholly informally, in deprived and rural areas compared with affluent and urban areas. For example, 31% of entrepreneurs in English deprived localities operate wholly in the informal economy compared with just 6% in affluent areas. The tentative suggestion is therefore that deprived and rural communities might be more enterprising and entrepreneurial than currently recognized and that legitimizing this hidden enterprise culture, especially in these locality-types, could be an innovative and effective means of promoting economic development and growth (Cáceres, Guzmán, and Rekowski 2011; Cavalcante, Kesting, and Ulhøi 2011; Goktan and Miles 2011; Hotho and Champion 2011; Huarng and Yu 2011; Naranjo-Valencia, Jiménez-Jiménez, and Sanz-Valle 2011).

Turning to the nature of informal entrepreneurship, few studies have so far sought to unpack its heterogeneous forms. Those that tend to differentiate informal entrepreneurs firstly, by whether they trade wholly or partially in the informal economy and secondly, by whether they have any intention of formalizing or not

(Katungi, Neale, and Barbour 2006; Williams 2006; Llanes and Barbour 2007; Cegarra-Navarro, Sánchez-Vidal, and Cegarra-Leiva 2011). The finding is that in Russia, 96% trade wholly in the informal economy, 51% in Ukraine but just 20% in England, and that around a half to two-thirds of all informal entrepreneurs in all these countries are on a journey towards formalization (Williams 2009). Based on this, four broad varieties of informal entrepreneur can be here discerned:

- ‘permanent entrepreneurial ghosts’ operating unregistered enterprises wholly in the informal economy with no intention of formalizing in the foreseeable future;
- ‘temporary entrepreneurial ghosts’ again operating unregistered enterprises wholly informally but with an intention to formalize;
- ‘permanent entrepreneurial moonlighters’ operating registered businesses and paying tax but not declaring a proportion of their income and with no intention of increasing the share they declare and
- ‘temporary entrepreneurial moonlighters’ operating registered businesses that do not declare a proportion of their income but are in transition to formalization.

These four types potentially might have different motives for operating informally. Until now, however, no studies have even evaluated entrepreneurs’ motives for operating informally, never mind whether different types of informal entrepreneur have varying rationales.

Instead, the only motive so far investigated is their reasons for engaging in entrepreneurship. When doing so, and akin to the literature on legitimate entrepreneurs’ motives, the necessity/opportunity dichotomy has taken centre stage (Reynolds et al. 2002; Maritz 2004; Smallbone and Welter 2004; Perunović 2005; Aidis et al. 2006; Harding et al. 2006; Minniti, Bygrave, and Autio 2006). The distinction has been between informal entrepreneurs motivated by economic needs and doing so because other options for work are absent or unsatisfactory, and those driven by a desire for self-realization and who do so out of choice such as to exploit some business opportunity or due to their desire for independence or to own a business.

Indeed, four distinct waves of thought on informal entrepreneurs’ motives for engaging in entrepreneurship can be identified. A first wave of studies assumed that informal entrepreneurs were all necessity-driven (Boyle 1994; Sassen 1997; Gallin 2001). As Travers (2002, 2) puts it, ‘most research on the informal economy gives short shrift to the motivations of people to do this work. It is usually said that people do the work to earn extra money and is left at that’. Informal entrepreneurship was thus portrayed as ‘involuntary’, ‘forced’, ‘reluctant’ or ‘survivalist’ (Boyle 1994; Valenzuela 2001; Singh and De Noble 2003; Hughes 2006; Bourne 2011; Hormiga, Batista-Canino, and Sánchez-Medina 2011; Mainardes, Alves, and Raposo 2011; Yang and Li 2011). A second wave then argued the inverse; that they voluntarily choose to be entrepreneurs (Gerxhani 2004; Maloney 2004). As Snyder (2004) finds, all 50 informal entrepreneurs she studied in New York City’s East Village were doing so out of choice, such as to set their careers on a new path, to transform their work identity or to reveal their true selves. Cross (1997) reaches the same conclusion when studying street vendors in Latin America.

A third wave of thought then transcended these two earlier waves, depicting informal entrepreneurs as universally either necessity- or opportunity-driven, by

examining the ratio of opportunity-to-necessity entrepreneurship, akin to the literature on legitimate entrepreneurship (e.g. Maritz 2004; Perunović 2005; Harding et al. 2006; Minniti, Bygrave, and Autio 2006; Andersén 2011; Aspara et al. 2011; Liu and Hsu 2011; Park, Lee, and Hong 2011; Smolarski and Kut 2011). Studying 50 dealers at flea markets in Northern California, Lozano (1989) reveals that 80% were involuntary entrants and the remaining 20% voluntary entrants. Subsequently, studies in rural and urban North America (Valenzuela 2001; Edcomb and Thetford 2004) have similarly identified the ratio of necessity-to-opportunity amongst informal entrepreneurs.

These three waves of thought all assume that individual entrepreneurs are either necessity- or opportunity-driven, viewing necessity and opportunity as discrete categories constituted via their negation to each other; they assume that to be an entrepreneur out of choice means that one is not necessity-driven. Recently, however, a fourth wave of thought, again mirroring studies of legitimate entrepreneurs' motives (Smallbone and Welter 2004; Aidis et al. 2006), has begun to unravel how opportunity- and necessity-drivers are often co-present in informal entrepreneurs' motives and also how the balance accorded to each changes over time for individual entrepreneurs (Snyder 2004; Williams 2009, 2010).

This literature on informal entrepreneurs' motives, nevertheless, only addresses their reasons for engaging in entrepreneurship, not their reasons for operating in the informal economy. Until now, this has not been evaluated. The aim of this paper is therefore to begin to fill this gap in order to understand how public policy might intervene to tackle informal entrepreneurship.

### 3. Methodology

To evaluate this sensitive issue, and given that a large proportion of UK enterprises are home-based (Mason, Carter, and Tagg 2008), the decision was taken to conduct face-to-face interviews with entrepreneurs using a household rather than business premise survey. In 2006, a middle-ranking locality in terms of its level of multiple deprivation was selected (DCLG 2000), namely Bassetlaw in North Nottinghamshire, which is situated between the coalfields of Derbyshire, agricultural Lincolnshire and industrial South Yorkshire, with a population of some 105,700 concentrated in the towns of Worksop and Retford. Indeed, the only real distinguishing feature of this area is that it is the original home of the Pilgrim fathers who set sail for the Newfoundland of America in 1620.

Following this, and given that the level of multiple deprivation has previously been shown to influence the extent and nature of informal entrepreneurship (e.g. Williams 2009; Williams and Nadin 2010), maximum variation sampling was used to select three wards with contrasting levels of multiple deprivation based on the 2000 Index of Multiple Deprivation (DCLG 2000) that ranks all wards in England and Wales. The most affluent ward within the locality was selected (i.e. Blyth ranked 6070 out of 8414 wards nationally), the middle-ranking ward (i.e. East Retford West ranked 2451) and the ward displaying the highest level of multiple deprivation in Bassetlaw (i.e. Worksop South East ranked the 122nd most deprived ward in the UK). This ensured that a full range of socio-economic environments were studied so that the results did not reflect the specific conditions of a particular type of ward as might have been the case if just one ward had been chosen.



To ensure that the data collected were representative in each ward, a spatially stratified sampling method was employed (Kitchin and Tate 2000). Every  $n$ th dwelling was targeted, depending on the number of households in the ward, in order to generate 40 interviews in each locality (120 in total). If there was no response, then after one call back, the  $n$ th + 1 dwelling was surveyed and failing this, the  $n$ th - 1,  $n$ th + 2 and so forth until an interview was completed. This provided a spatially stratified sample and prevented the interviews being skewed towards certain tenures, types of dwelling and different parts of the ward. For each household, furthermore, the 'closest birthday' rule (i.e. a random date is chosen and the person with the birthday closest to it selected) was used to select respondents for interview amongst those available in the household at the time.

The interview schedule gradually moved towards the more sensitive questions. Firstly, socio-demographic background data were collected on the household in terms of the age, gender, employment status and work history of household members as well as gross household income, including whether any household member had started-up a business venture in the past 36 months. If so, secondly, the nature of their business start-up was investigated including the number employed, the length of time it had existed, its economic sector and the level and nature of the income. Thirdly, attitudinal questions were asked about the extent of the informal economy in their sector. The fourth and final sections then moved onto whether they traded informally so far as their entrepreneurial endeavour was concerned. This firstly asked, 'Many businesses start-up doing some of their transactions partially or wholly off-the-books. Did you do any off-the-books transactions at the start of your business?'. Following this, further probes enquired about whether they continued to do so, whether the proportion was changing and whether they were seeking to formalize or not. Fifth and finally, open-ended questions were asked regarding their reasons for trading informally both at start-up and at present if relevant. Further probes included the interviewer inflecting their first response such as 'only to avoid paying tax?' and asking 'are there any other reasons?'.

Before reporting the results, it is important to state that this was a challenging survey to conduct. Participants often became fearful when responding to questions about their informality and required constant reiteration that we were university academics and the responses would be anonymous. Nevertheless, the participants proved generally reluctant to answer questions about their informal activities, often simply providing one word or one sentence answers. Interview transcripts were therefore relatively 'thin'. Nevertheless, all transcripts were subjected to a thematic analysis, with the themes determined predominantly by the interview questions. The more elaborate coding systems commonly associated with the thematic analysis of qualitative data were therefore unnecessary due to the limited depth and complexity of the data generated.

#### 4. Findings

The 120 households interviewed (40 in each ward) revealed a high-level of entrepreneurship in Bassetlaw. Of the 283 adults in the households interviewed, some 51 had started-up an enterprise in the past three years. Of these, eight (16%) had registered their enterprise and did not participate in the informal economy. The remaining 43 entrepreneurs (84%) reported that they operated wholly or partially in



the informal economy. Of these, and as Table 1 displays, 14 (27% of all entrepreneurs and 33% of all informal entrepreneurs) operated unregistered wholly informal enterprises ('entrepreneurial ghosts') and 29 (57% of all entrepreneurs and 67% of all informal entrepreneurs) were registered enterprises trading partially in the informal economy ('entrepreneurial moonlighters'). Moreover, some 58% of entrepreneurs view themselves as not in transition to formality and just 42% as on a journey towards formalization.

The configuration of the hidden enterprise culture, however, is not everywhere the same. In the deprived neighbourhood, a greater proportion of informal entrepreneurs are ghosts (43%) and a smaller proportion on a journey towards formalization. In the affluent neighbourhood, in contrast, a greater proportion of informal entrepreneurs are moonlighters and formalizing. Figure 1 graphically depicts this differing spatial configuration of informal entrepreneurship. Given that the configuration of the hidden enterprise culture varies socio-spatially, the intimation is that if the motives for operating informally vary across different kinds of informal entrepreneurship, then so too will the importance of various rationales for informal entrepreneurship vary socio-spatially and therefore different policy approaches will be required in various populations.

A thematic analysis of the transcripts reveals that informal entrepreneurs' motives vary according to whether they are ghosts or moonlighters and in transition to formality or not. It is to these differing rationales that attention now turns.

Table 1. Types of informal entrepreneurship in North Nottinghamshire: by ward-type.

Rationale	All wards		Deprived ward		Middle-ranking ward		Affluent ward	
	No.	%	No.	%	No.	%	No.	%
Permanent ghosts	11	26	6	43	4	33	1	6
Temporary ghosts	3	7	0	0	1	8	2	12
Permanent moonlighters	14	32	5	36	4	33	5	29
Temporary moonlighters	15	35	3	21	3	25	9	53
Total	43	100	14	100	12	100	17	100

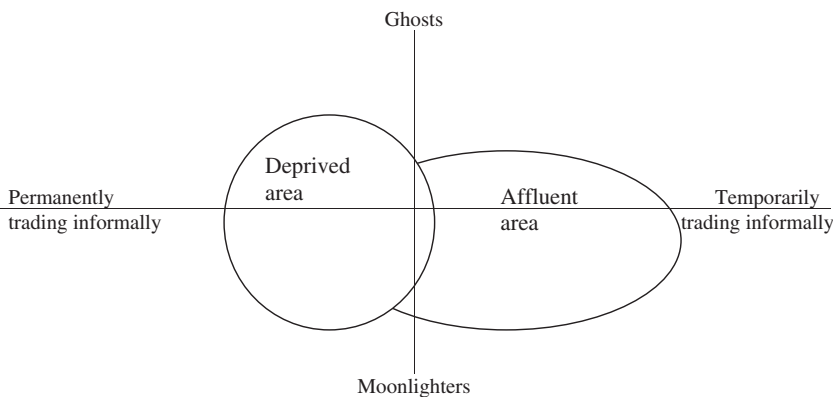


Figure 1. Configuration of informal entrepreneurship: by area-type.

#### 4.1. Rationales of permanent entrepreneurial ghosts

Of the 51 entrepreneurs surveyed, 11 (22% of all entrepreneurs and 26% of all informal entrepreneurs) operated unregistered wholly informal enterprises and had no intention of formalizing. This is particularly so in deprived neighbourhoods, suggesting that deprived communities are perhaps more enterprising and entrepreneurial than is currently recognized (Williams 2006). Consequently, legitimizing them could be an important means of promoting economic development and growth.

Examining these permanent entrepreneurial ghosts, three sub-groups can be identified based on their official employment status. Firstly, four participants were registered unemployed people who had not registered their enterprise or declared their earnings. This was because they were uncertain about the viability of the enterprise and feared losing their benefits. As an unemployed woman making and selling dog collars stated,

you cannot make a living doing this. Some weeks I sell some, others I don't. If I told the social, they would cut my benefits. It's far too complicated with how it would influence my benefits to even think about telling them.

It was also because operating legitimately was seen as too costly due to the tax and national insurance payments required and all felt formalizing to be simply 'not worthwhile'. Moreover, most heavily emphasized that they only sold goods and services to people they knew, not least in order to keep the enterprise 'hidden', and had only small and intermittent incomes, leading them to view it as not a 'real business'. As a woman making tailor-made Christmas stockings using her sewing machine stated, 'It's more a pastime that makes me a bit of money than a real business'. Or as an unemployed man doing decorating jobs stated,

Often they pay you mate's rates. Sometimes I get a lot more than I should. Other times I get a lot less than the going rate. I just do decorating for people I know. That's not a real business is it.

However, all agreed that if their customer base and turnover expanded, they might feel differently about registering the business. As a woman who did hair-beading asserted:

I just do it for folks I know. I don't advertise or nothing like that. If I did, I would have to tell the social. Really, it's not a real business. I don't advertise, I don't have premises and all that stuff. If I was proper, I'd tell them and sign off.

In sum, these registered unemployed operate as permanent ghosts due to: the perceived difficulties involved in declaring their enterprises whilst claiming benefits; the limited and intermittent income received and their view that they do not operate a real business because the clients are often people they know, they often do not receive or charge market rates and they do not have business premises.

Secondly, three of the permanent ghosts surveyed were economically inactive (two retired and one a house person), and lived in the middle-ranked and affluent wards. One made bespoke curtains and soft furnishings in order to earn additional household income and saw no reason to declare her earnings since she considered her husband paid more than enough in taxes. A retired man, meanwhile, made and sold model railway paraphernalia but saw this more as a hobby than a business venture and a supplement to his state pension. In his eyes, he had contributed enough tax over his lifetime and the state had no right to tax this additional income which paid for his hobby. None intended to register their business. Their reasons for operating

informally, therefore, chiefly revolved around their view that they do not operate a proper business and a lack of tax morality due to their perception of the injustice and lack of fairness involved in paying tax on their earnings.

Thirdly and finally, the remaining four permanent ghosts were formal employees, namely a kitchen fitter, landscape gardener, electrician and an IT worker. Each made contact with their customers via their formal occupation and then did jobs informally in the evenings or at weekends for cheaper rates than the business for which they worked. When pricing customers' jobs, they gave a rate for the business and one for them to do it on their own account. None of the informal entrepreneurs operating these 'parasitic' enterprises considered it feasible to register their enterprise or operate formally because: it would signal their activity to their existing employer, they saw it as an illegitimate activity and they claimed that if they had to pay taxes, they would no longer be able to undercut their current employer on price. Consequently, formalization was not seen as a viable option.

#### **4.2. Rationales of temporary entrepreneurial ghosts**

Three (6%) of the 51 entrepreneurs operated unregistered wholly informal enterprises but had the intention of formalizing. Unlike the permanent ghosts who were largely located in the deprived neighbourhood, these temporary ghosts were located in the middle-ranking and affluent neighbourhoods.

Two were house persons and one a formal employee, a painter and decorator operating a parasitic business venture. For the latter, once he had built up a sufficient client base, he intended to spin-off from his formal employer and become self-employed. He then intended to register the business and do at least a portion of trade formally. His reasons for operating informally were the same as the permanent ghosts above operating 'parasitic' business ventures. However, his route to formalization was to make the transition from employee to self-employment.

The two house persons operating as ghosts, meanwhile, included a woman who did ironing and another who did domestic cleaning for a number of clients. Both asserted that they had so many clients because they lived in the same neighbourhood as their clients and there was therefore more of a relationship of trust. For both, their intention was that once they had expanded their customer base, they would employ others to do some of the work for them (from other neighbourhoods who did not have the same contacts and ability to gain trust) and they would then register the business and do at least a portion of their trade formally. For the moment, however, they had not formalized because they did not see their enterprise as a 'real' business, they had limited and intermittent income streams and feared losing some of their state benefits (tax credits) if they declared their earnings. Nevertheless, they wanted to formalize in the future, especially if the business expanded and they took on additional employees.

#### **4.3. Rationales of serial entrepreneurial moonlighters**

Analysing the 14 entrepreneurs with registered businesses operating partially in the informal economy with no intention of more fully formalizing, very few had witnessed problems registering as self-employed. As one participant put it, 'It's great.

One phone call and that is it'. Only one mentioned any problem. A woman operating an alternative therapy business stated,

I phoned up to register and the first thing they did was to fine me because I hadn't registered within the time limit of doing my first trade. It wasn't a good start in terms of my view of them [the tax authority] and their money-grabbing attitude.

Registering as a company or partnership, nevertheless, was perceived as more problematic, with all asserting that it took a considerable amount and long period of time. Similarly, filing tax returns was widely viewed as problematic, with these serial entrepreneurial moonlighters variously stating that it was 'nerve wracking', 'scary', 'too complicated' and 'hard work'.

Examining their reasons for operating informally, five reasons are apparent. Firstly, six viewed their informal trading as being positive rather than negative in terms of its impacts. As an electrician stated, 'I do cash jobs for old folks or people without money. That's not me being on the fiddle. That's me helping out a lot of people who wouldn't be able to afford to get the work done'. Secondly, four participants viewed what they did as small-scale fiddling and keeping their own money, which is not the same as benefit cheats and larger businesses who take other people's money. As a retailer commented, 'I just sometimes don't put a sale through my till. I'm not like the big multinationals who never pay tax'. Or as a plumber put it, 'I work hard and just keep a little of what I earn for myself. I don't rip off the state like all those scroungers claiming benefits who work and steal our money'. Thirdly, eight participants thought it acceptable to work informally because 'everybody else' does so. As a builder asserted, 'In my business, everybody does it so you'd never get any jobs if you didn't'. Fourthly, four participants put the blame squarely on the shoulders of the government, tax authorities or law for their informality. As a restaurant owner claimed, 'I get nothing back from the government for what I pay in taxes, so I see no reason to pay it if I don't need to'. Fifth and finally, 11 stated that working informally was a necessity to stay in business. As participants stated, 'it's the only way to make a profit', 'doing cash-in-hand stops you going bankrupt', 'it makes all the difference' and 'it keeps the business afloat'.

#### **4.4. Rationales of temporary entrepreneurial moonlighters**

Some 15 entrepreneurs had registered businesses operating partially in the informal economy but were on, or intended to pursue, a journey towards formalization. A further eight were registered and fully formalized. For these formalizing or formalized entrepreneurs, nevertheless, and reflecting on their experiences, four main barriers to formalization were identified. Firstly, there is pressure from customers demanding to pay cash-in-hand, secondly, being fully compliant was seen to be a lengthy and complex process ('it is difficult to even know what you need to do to be legit, never mind actually do it'), thirdly, there was a lack of advice on how to make the transition to formality and fourth and finally, a strong feeling that when starting out, the perceived benefits of formalization might not always outweigh the potential costs of remaining informal. All the formalized and formalizing participants, however, believed in legitimizing because of the new markets it opened up, the positive sense of identity owning a 'proper' business brought and the fact that they were no longer fearful of being caught.

Ghosts	
Fear of losing social benefits Not seen as a 'real' business Limited and intermittent income streams Lack of tax morality Perceived injustice and unfairness of tax office Perceive their endeavour as illegitimate	Fear of losing social benefits Not seen as a 'real' business Limited and intermittent income streams
Permanently	Temporarily
Trading informally  Problems of registering as company View their informality as having positive, not negative, impacts View their endeavour as small-scale fiddling and not real evasion Everybody else doing it Tax unfairness and tax injustice Necessity to stay in business	Trading informally  Pressure from customers Complexity of compliance process Lack of advice on how to formalize Perception that benefits might not outweigh costs
Moonlighters	

Figure 2. Entrepreneurs' motives for working informally: by type of informal entrepreneur.

In sum, and as Figure 2 summarizes, informal entrepreneurs' motives for operating informally vary by whether they work wholly or partially in the informal economy and are in transition to formality or not. The clear implication is that different policy approaches will be required to tackle the different barriers to formalization faced by each type of informal entrepreneur. It is to this that attention now turns.

**5. Policy approaches towards the hidden enterprise culture**

A potentially effective and innovative way of promoting economic development and growth might be to help these informal entrepreneurs to formalize. However, therefore, could this be achieved? Given the contrasting rationales for operating informally amongst these four types of informal entrepreneur, this section addresses the bespoke policy measures required to tackle the varying barriers to formalization that each confront.

**5.1. Tackling permanent entrepreneurial ghosts**

For the registered unemployed operating as wholly informal entrepreneurs, a first step to help them formalize would be to change the earnings disregard (i.e. the amount the unemployed can earn without losing entitlement to their benefits) to an annual rather than weekly disregard, as proposed in the UK by the White Paper on universal credit (DWP 2010). This proposes annual disregards of £3000 for a couple household, plus £2700 for each child per household, £5000 for lone parents plus £2700 for each child per household and £7000 for a disabled person. If implemented, it would formalize in one action much of this informal endeavour. Nevertheless, if solely this is implemented, these entrepreneurs would still have no incentive to grow

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their business because turnover would need to remain below the annual earnings disregard.

To facilitate growth and smooth their transition to self-employment, a gradual replacement of benefits by self-employed income could be used. One approach is to expand and extend the UK Department of Work and Pensions 'test trading' initiative which involves unemployed people test-trading their business for up to 26 weeks during which they receive an allowance equivalent to their previous benefit entitlements and also a grant of up to £400 paid in equal weekly or fortnightly instalments. The money the business earns whilst in the test-trading period is either ploughed back into the business or stored in a special bank account until the test-trading period has ended (Small Business Council 2004). This measure might more effectively facilitate formalization if the eligibility period was reduced (currently 18 months unemployment), the current 26-week test-trading period was extended up to 3 years, and a more graduated withdrawal from benefits and parallel graduated release of the money earned by the business was implemented. An example in this latter regard is the Ich AG scheme in Germany. Unemployed people starting up as self-employed receive 50% of the average unemployment benefit level in the first year, 30% in the second year and 20% in the third and final year. The German government expected around 20,000 start-ups to be launched (Renooy 2007). Between 2003 and 2006, however, 400,000 entrepreneurs were supported and 75% remained operating 28 months later. Given that 60% had already acquired their first customers before entering the Ich AG scheme (Baumgartner, Caliendo, and Steiner 2006), this measure secured the formalization of some 240,000 off-the-books business start-ups. Another option for smoothing the transition to self-employment, proposed in the UK White Paper on universal credit, is that as earnings rise, universal credit will be withdrawn at a constant rate of around 65 pence for each pound of net earnings (DWP 2010). This 65% taper results in people being 35 pence better-off for each £1 of net earnings over the earnings disregard limit, and would provide a clear rationale for expanding and growing the business.

To legitimize the economically inactive who are permanent entrepreneurial ghosts, meanwhile, tax authorities could allow small jobs to be conducted up to a tax free limit and/or with greatly reduced tax and social contribution rates if declared on their self-assessed tax return. A 'mini-jobs' initiative in Germany did this by allowing earnings up to €800 per annum at greatly reduced tax and social contribution rates. By 2004, seven million had registered and 580,000 were estimated to have formalized their small-scale off-the-books endeavour using this scheme (Baumann and Wienges 2003).

To tackle formal employees operating as 'parasitic' entrepreneurs who steal customers from their formal employer, one way forward is to nurture greater commitment to tax morality through education campaigns (see below). Another approach is to encourage employers to pay fairer wages and to work towards strengthening the psychological contract between employers and employees so as to avoid such enterprises emerging in the first place.

## **5.2. Tackling temporary entrepreneurial ghosts**

Given that the temporary entrepreneurial ghosts surveyed were either economically inactive or operating parasitic business ventures, the policy measures required to



facilitate their journey to formalization are similar to permanent entrepreneurial ghosts. For the economically inactive, the tax authorities might again allow small jobs to be conducted up to a tax free limit and/or with greatly reduced tax and social contribution rates if declared on their self-assessed tax return, such as by using a system similar to the 'mini-jobs' measure in Germany discussed above. Alternatively, the universal credit proposals discussed above could also be applied to this group. This would formalize much of this informal entrepreneurship.

For temporary entrepreneurial ghosts who are formal employees stealing customers from their formal employer, it is perhaps not so much nurturing greater commitment to tax morality through education campaigns, or striving for fairer wages and a stronger psychological contract between employers and employees, but more the provision of advice and support to help them make the transition to formality. How this might be achieved will be shown below.

### 5.3. Tackling serial entrepreneurial moonlighters

Given that registering as self-employed was easy but registering as a company was not, making it easier to register a company or partnership, such as by providing help-lines and reducing the steps involved, is one way forward. In this regard, there are lessons to learn from the 'On the Spot' firm (*Empresa na Hora*) initiative introduced in 2005 in Portugal. This allows the creation of a company in a one-stop shop in a single day. Between 2005 and 2008, 59,068 new enterprises were created in an average time of 1 h 14 m at an average cost of €360 (Williams and Renooy 2009). There is also the issue of reducing the stress involved in completing tax returns. One way forward is introducing a standard deduction for expenses in different sectors (Elffers and Hessing 1997).

Given that many serial entrepreneurial moonlighters lack tax morality in that they do not wish to pay their full taxes, and that tax morality is correlated with the level of tax knowledge (Erikson and Fallan 1996), improving tax knowledge would facilitate greater formality. This could range from providing information on where taxes are spent to publicity campaigns to engender a culture of commitment to tax morality. The intention would be for entrepreneurs to regulate themselves rather than be regulated by external rules. Evaluating the advertising campaign run by Her Majesty's Revenue & Customs in the UK between 2005 and 2007 advertising that self-employed people needed to register, 5000 individuals used the helpline to register in this timeframe and this additional registration will generate £23 million in receipts over a three -year period (National Audit Office 2008). Information campaigns are arguably most effective when they focus upon the benefits of declared work rather than the risks and costs of informality (Torgler 2007). A key aspect of such campaigns could be the use of 'role models' at the local and national levels extolling the benefits of formality.

Advertising the benefits of formalizing, however, needs to be coupled with punitive measures for those refusing to make the transition. Telephone hotlines, increased penalties, tax surcharges and prosecutions for those caught working informally and greater publicity of those caught might be useful in this regard (Williams and Renooy 2009). However, the evidence is divided on whether deterrence is effective. Whilst some evaluations find that increasing fines reduces informality, others identify that increasing penalties leads to a growth in such work



(for a review, see Williams and Renooy 2009). As Chang and Lai (2004) find for example, raising fines will give rise to a strong venal effect that increases rather than lowers tax evasion. Murphy (2005) similarly discovers that the use of threat and legal authority can produce the opposite behaviour, namely non-compliance, creative compliance, criminal behaviour or even overt opposition. Indeed, some even conclude that 'it is not sensible to penalize illicit work with intensified controls and higher fines' (Schneider and Enste 2002, 192).

#### **5.4. Tackling entrepreneurial moonlighters in transition to legitimacy**

For entrepreneurial moonlighters already formalizing, it is not advertising the benefits of formalization but tackling the barriers to formalization that is required. To achieve this, bespoke advice and support is required (Copisarow and Barbour 2004; Small Business Council 2004; Williams 2006). One option is to introduce anonymous telephone lines/Internet chat-lines offering advice to those wishing to leave the informal economy. Another option is the development of a 'formalization service'. The CUORE (Centri Operativi per la Riqualficazione Economica) initiative in Naples in Italy is one example. Neighbourhood centres provide help and advice to informal entrepreneurs wishing to formalize, devising customized formalization paths and then monitoring each step to ensure the path still suits the enterprise. In total, 1280 informal entrepreneurs have received counselling. Help is also provided with advertising, training, trade fairs arranged, copyright help provided and aid with internationalizing their markets, thus creating incentives for businesses to formalize (Bàculo 2006).

To tackle purchasers requesting 'how much for cash?', straightforward income tax relief can be offered, claimed on (self-assessed) tax returns, to those employing businesses formally to do specific home improvement and maintenance tasks for example. Another customer-focused option is to use service voucher schemes. In Belgium, vouchers can be used to pay for everyday personal services. Each voucher costs €6.70 and this pays for an hour of work from certified companies that hire unemployed people. The household pays with the vouchers whose cost price is €21.00 in 2005 prices. The difference is paid to the company by the federal government. The household can recover 30% of the price of the voucher in their tax return, meaning the price for one hour of work is €4.69. By the end of 2005, 28,933 people had been employed through this service voucher scheme (Gevers, van Pelt, and Peeters 2005). Customer surveys reveal that 44% of the transactions using service vouchers were previously conducted informally (Renooy 2007).

In sum, informal entrepreneurs' motives vary according to whether they are ghosts and moonlighters and view themselves as in transition to formalization or not. The outcome, as Figure 3 reveals, is that 'one size does not fit all' so far as policy approaches are concerned. Different policy measures are required to tackle the contrasting barriers to formalization witnessed by these varying segments of the hidden enterprise culture. It also suggests that varying policy measures will be more salient for tackling informal entrepreneurship in some locality-types than others, given the different spatial configurations of the hidden enterprise culture.

Ghosts	
Create annual benefits earnings disregard Extend test-trading initiative Recognise existence of 'small/odd jobs' in tax system Pursue greater commitment to tax morality Pursue fairer wages by employers Strengthen psychological contract between employers and employees	Recognize existence of "small/odd jobs" in tax system Provide advice and support on how to formalize
Permanently	Temporarily
Trading informally	Trading informally
Simplify business registration procedures Simplify tax returns Information campaigns to improve tax knowledge Use of positive 'role models' Administrative penalties and tax surcharges	Help-lines on tax compliance Formalization service Income tax relief to customers Service vouchers
Moonlighters	

Figure 3. Policy measures required to tackle the hidden enterprise culture: by type of informal entrepreneur.

**6. Conclusions**

The starting point of this paper was that despite a burgeoning literature on informal entrepreneurship, no studies have evaluated entrepreneurs' motives for working in the informal economy. The result is a poor understanding of how to facilitate formalization. To fill this gap, entrepreneurs' motives for operating informally in a North Nottinghamshire locality have been reported. This has revealed that entrepreneurs' rationales for working informally vary according to the extent to which they operate informally and whether they are in transition to formality or not.

Analysing permanent entrepreneurial ghosts, the finding is that most conduct intermittent small odd jobs and do not perceive their enterprise as a real business. To tackle such informal entrepreneurship amongst the registered unemployed, changing the earnings disregard to an annual disregard would formalize much of this endeavour and coupling this with measures to allow a gradual transition from benefits to self-employment, such as by extending the UK's test-trading initiative, replicating the Ich AG scheme in Germany or implementing the universal credit system advocated in the UK, would then enable them to grow their enterprises. Economically inactive permanent entrepreneurial ghosts, meanwhile, who again conduct largely small-scale trading, could be largely formalized by introducing a 'mini-jobs' category of work declared on tax returns but exempted from tax or taxed at low rates. For formal employees operating 'parasitic' ventures, meanwhile, it is more promoting greater commitment to tax morality through education campaigns coupled with employers paying fairer wages and a strengthening of the psychological contract between employers and employees which is needed.

To deal with entrepreneurial ghosts who already possess a desire to formalize, and given that most are either economically inactive or operating parasitic business

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ventures, the policy measures required to facilitate formalization are similar to the permanent ghosts above. If tax authorities allowed small jobs to be conducted up to a tax free limit and/or greatly reduced tax and social contribution rates if declared on their self-assessed tax return, this would formalize much informal entrepreneurship by the economically inactive. For those operating 'parasitic' ventures that steal customers from their formal employer, but who intend to formalize their enterprise, it is not so much nurturing tax morality, but more the provision of advice and support to help them make the transition to formality that is required.

To tackle permanent moonlighters operating registered business start-ups partially trading informally on a serial on-going basis with no intention of reducing or stopping their level of informality, registering a formal business needs to be made easier by providing help-lines and/or cutting out some of the steps involved. There is also the need to reduce the complexity and stress of completing tax returns, such as by introducing a standard deduction for expenses in different sectors. Primarily, however, it is encouraging tax morality through tax education which is required. This includes providing information on how taxes are spent to engender a culture of commitment to tax morality so that entrepreneurs regulate themselves rather than be regulated by external rules. Such education campaigns need to focus upon the benefits of formalization and to use role models to explain the virtues of full formalization, although this needs to be coupled with the threat of punitive measures for those not making the transition.

Examining entrepreneurial moonlighters partially trading in the informal economy but formalizing, it is less advertising the benefits of formalization and more tackling the current barriers they face that is required. These are fourfold: purchasers who demand 'how much for cash?'; the complexity of the compliance procedures; the lack of advice on how to formalize and the perception that the benefits might not outweigh the costs. To tackle purchasers requesting cash-in-hand trades, income tax relief on self-assessed tax returns could be introduced when invoices are received for specific household tasks, or alternatively, purchasers of formal services can be offered incentives such as service vouchers. A bespoke 'formalization service' along with anonymous telephone/Internet chat-lines to offer advice and support is also required.

However, it is important to note that these findings on entrepreneurs' motives for working informally and policy proposals result from interviews with just 43 informal entrepreneurs in one middle-ranking UK locality. Further research will be required in other populations, especially deprived and affluent localities in other populations and countries, to evaluate whether the rationales for informality are the same or different amongst each segment of the hidden enterprise culture and therefore whether the same or different policy measures need to be applied to each type of informal entrepreneurship. This paper has therefore made a start on moving the academic literature beyond universal explanations of informal entrepreneurs' motives and policy discussions beyond a 'one size fits all' policy approach for dealing with the hidden enterprise culture. If it now stimulates further unravelling of the heterogeneous motives underpinning different kinds of informal entrepreneurship and more informed and nuanced debate on what needs to be done about the varying segments of this hidden enterprise culture, then this paper will have achieved its objectives.

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