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THE DYNAMICS OF ENTREPRENEURSHIP IN THE INFORMAL ECONOMY

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Abstract

This study reviews the primary considerations in answering the controversial questions about the Informal Sector. The informal sector is a significant part of the Nigerian economy and provides goods and services to millions of Nigerians. It is also a vital source of employment, especially for those who cannot secure work in the formal sector. According to the International Labour Organization (ILO), the common characteristics of an informal enterprise include the ease of entry, reliance on indigenous resources, family ownership, small-scaled operations, labour intensive, adaptive technology, and unregulated and competitive markets. The objective of this study is to examine the characteristics of the informal entrepreneurs, reasons for operating informally, and entrepreneurial strengths of the informal economy.

Keywords: Informal Sector, Formal Sector, Informal Economy, Institutional Voids, Opportunity Exploitation, Entrepreneurs, Informality, Micro-enterprise.

Introduction

In recent decades, there has been a rapid narrative of the informal economy among various economists (Altman, 2008; Amin, 2002) and other academic scholars (e.g., Williams & Gurtoo, 2011; Williams & Nadin, 2010; Gerxhani, 2004; Maloney, 2004; Snyder, 2004) and policy institutions (e.g., ILO, 2002; Oberay & Chadaw, 2001; Mateman & Renooy, 2001). It is now widely recognised that the informal economy is not some minor practice only persisting in a few marginal populations. Indeed, of the global working population of some three billion, nearly two-thirds (1.8 billion) work in the informal economy (Jütting & Laiglesia, 2009), the majority of whom work on a self-employed own-account basis: 70% of all informal workers in Sub-Saharan Africa, 62% in North Africa, 60% in Latin America, 59% in Asia (ILO, 2002) and 77% in the European Union (Williams & Windebank, 2011). This estimates that a large proportion of entrepreneurs globally might operate in the informal economy.

There is a consensus among researchers that the informal economy has characteristics such as ease of entry, dependence on local resources, family ownership, small-scaled operations, labour intensive, adaptive technology, skills acquired outside of the formal sector, unregulated and competitive markets, and can be formed through any informally organized activities (Ahmad et al., 2011; Bangasser, 2000; Hart, 1973). In addition, informal entrepreneurship can be similar to other classifications of entrepreneurial activities such as public entrepreneurship, working from home, emerging businesses, and self-employment

(Henley et al., 2009; Kus, 2014). Subsequently, the informal economy, as identified by Williams (2007), involves informal activities in the informal sector that only includes paid work, which is illegal because of its non-declaration to the state for tax with or without social security purposes.

However, as Williams and Nadin (2010) argue, few studies have so far evaluated whether this is the case, and what has been an even more daunting gap in the literature is the explanation of motives for these entrepreneurs to conduct their business in the informal economy. To fill the gap of this study, it is essential to focus on the characteristics of the informal economy in Nigeria, characteristics of informal entrepreneurs, reasons for operating informally, and the entrepreneurial strength of the informal entrepreneurs. Informal sector entrepreneurship is here defined using the conventional ILO definition, which asserts that the informal sector consists of unregistered or small unincorporated private enterprises engaged in producing goods or services for sale. An unincorporated enterprise refers to a production unit that is not constituted as a separate legal entity operating independently of the individual (or group of individuals) who owns it and for which no complete set of accounts is kept. Meanwhile, an enterprise is unregistered when it is not registered under specific national legislation forms (e.g., factories or commercial acts, tax or social security laws, professional groups' regulatory acts). Issuing of a trade licence or business permit under local regulations does not qualify as registration. An enterprise is considered small when its size - in terms of employment - is below a specific threshold (e.g., ten employees), determined according to national circumstances. Given this definition of the informal sector, informal sector entrepreneurs are, therefore, persons operating in the informal sector who are either (i) own-account workers employed in their informal sector enterprises or (ii) employers employed in their informal sector enterprises (ILO, 2011).

Additionally, the informal sector with its own account of little or no organisation or capital, and casual employment, remains a major, if not the major, source of employment (Baharudin et al., 2011). The informal economy also has recently become a label for economic activities, which take place outside of the framework of public and private sector corporate establishments (Webb et al., 2013).

Informal economic activities in Nigeria

According to the World Bank (2014), Nigeria had faced challenges to macroeconomic management related to weakening oil revenues and volatile short-term capital flows. Gross foreign and fiscal reserves declined steadily from April 2013 into the first quarter of 2014. The government met these challenges with prudent fiscal, monetary, and exchange rate policies, which succeeded in maintaining economic stability, reducing the pace of inflation, and contributing to investor confidence and stabilising the balance of payments position in the second quarter of 2014. The planned Revenue Framework and Federal Budget for 2014 suggested a resolve to maintain fiscal prudence considering lower oil revenues, despite growing pressures in the pre-election environment.

A statistical reassessment of national accounts data in the form of a GDP re-basing indicated an entirely different size, structure, and sectoral distribution of growth in the Nigerian economy, which appeared more diversified, with important growth sources coming from the informal sectors. Slower assessed agriculture growth in the newly re-based GDP figures was consistent with apparently slow poverty reduction in rural areas (World Bank, 2014).

Moreover, in Nigeria, during the economic crisis, citizens also started to migrate from the villages to urban areas in order to find better jobs. The effect of the crisis caused many people to lose their jobs and it drove most people to find an alternative way for their livelihood such as to join the informal sector and to get out of poverty (Ahmad et al., 2011).

The informal trader has to struggle to survive in the challenging urban areas. Not every person can follow the flow of modernisation with its high cost of living, as it is occurring in Nigeria. The improvement of the informal sector is also parallel to modernisation and the traders have to make an effort to not give up in the informal sector (Idris & Siwar, 2003). Furthermore, the oil sector remains a primary source of macroeconomic performance. Given the high dependence of the budgetary and balance of the country's payments positions on oil, the recent changes in prices have significantly weakened the Nigerian economy. A combination of regulatory uncertainty and increasing security challenges in the northern states have limited investment and output in the formal sector. Declining oil revenues relative to the size of the Nigerian economy are already necessitating fiscal adjustment. Therefore, it pushes people to partake in the different economic activities. Most people who do not have high skills or a good education prefer the informal sector, which is one of the entrepreneurship divisions. They start their own business in the informal sector due to the constraints in the formal sector.

Characteristics of informal entrepreneurs

Entrepreneurs are enthusiastic and ambitious in achieving success in their business (Chittithaworn et al., 2011). The success of the entrepreneurs can be measured through their performance. The enterprise's success or collapse depends on each entrepreneur's characteristics (Fisher et al., 2014). Seeking and having accurate awareness about business opportunities can also have an advantage in the success of an entrepreneur's life (Jawahar & Nigama, 2011; Islam et al., 2011).

Entrepreneurial characteristics usually consist of demographic characteristics, duration and size of the business, entrepreneurial orientation, source of finance, and business registration (Islam et al., 2011). Age, gender, and individual backgrounds, such as the entrepreneur's education and working experience, are examples of demographic characteristics that can influence intention and entrepreneurial effort in the informal economy (Hartati et al., 2015). Henley et al. (2009) referred to the nature of the informal employment as commonly substituting between sectors and that the employee may be involved in activities in both formal and informal sectors at the same time.

The size of a business or scale of operation is a dominant criterion for defining the literature's informal sector. It is most often measured by the number of people working in a unit. The small size of businesses in the informal sector has been mentioned in the literature since the first studies in this sector (ILO, 1972). Although there are some variations across countries, many papers mention the strong association between the scale of operation and formality, which indicates that the size (number of employees) is positively correlated to the possibility of formality (Maloney, 2004; La Porta & Shleifer, 2008; Pratap & Quintin, 2006; De Paula & Scheinkman, 2011).

However, business registration is one of the criteria commonly used to determine if it belongs to the informal sector. It is recommended by ILO as an official definition of the informal sector, although the type of registration varies according to the national context. In Nigeria, the government uses the Corporate Affairs Commission (CAC) to differentiate formal from informal businesses. Registration discloses the relationships between household businesses and the state. Thus, all household businesses, except for street vendors and road-side sellers, are obliged to register.

Subsequently, entrepreneurial orientation through independence, innovativeness, risk-taking, pro-activeness, competitive aggressiveness, and self-motivation helps business (Islam et al., 2011). Also, formal institutions provide the foundation for a person's motivation, which affects whether to register their business or not. Friedman et al. (2000) uses proxies for excessive government regulation and government institutions' quality and examine these

factors' impact on the informal sector. Similarly, De Soto (1989); Tokman (1992); Alm et al., (1995) assert that burdensome government regulations increase the informal sector's size.

Finally, the informal sector is also a supplier that offers prices and credit that are more flexible than the formal sector (Spring, 2009). In most cases, women sell their own products such as food, clothes, crafts, and pottery, whereas men make metal and wood products. Naturally, micro-entrepreneurs or informal traders use local resources and sell in local markets, which are different from globalists, who can use any level of resources from international product sources and markets (Spring, 2009; Williams, 2007). Globalists generally combine local and non-local regional and international communication with suppliers and buyers through the Internet. Supplies that require capital and direct connections to international markets are usually male-controlled, while women usually control local markets and the items that concern daily maintenance due to their limited cash resources (Spring, 2009).

Entrepreneurial strengths of the informal sector

At any rate, some studies tend to go beyond the impact of the widespread negative view about the informal sector by exploring its potentials. For example, Webb et al. (2009, 2013) use a mixture of theories, including institution, motivation-related, and resource allocation, to propose an extensive list of factors that explain the informal sector's opportunities. The authors list three critical factors: institutional distrust and imperfection, burdensome cost and procedures, and resource-constrained business environment. Moreover, they argue that the entrepreneurial capacity of the informal sector is more prominent in developing countries. Also, Godfrey (2011) explains that the failure of the formal sector's benefits and the imbalances between informal and formal institutions set the informal sector as the "first-best" alternative. Similarly, Amor-s et al. (2016) claim that a certain amount of informality is necessary for a practical substitute to the formal sector in countries where there are weak institutions. They also argue that the informal sector has a positive effect on economic development measured by the Human Development Index.

Furthermore, one key potential of the informal sector relates to how it allows for a better allocation of resources by exploiting idle economic areas. Williams et al. (2016) show that enterprise engagement in "late registration" (formalisation) is suitable for a better allocation of resources because it could be beneficial to the overall company. The researchers use a Heckman 2-step model with a firm-level WBES dataset from 127 developing countries and find that formal enterprises' performance that "start-up unregistered" and spent more years operating informally is better than those that allocated all their resources to register from the outset formally. Moreover, several scholars, such as Chen (2012) and Williams and Martinez (2014), highlight the importance of linkages from which formal and informal enterprises can benefit. As the informal sector provides the market with cheaper goods, services, and materials, formal enterprises engage in effective backward and forward linkages through subcontracting and outsourcing practices with the informal sector. These are standard practices in Sub-Saharan African countries but sometimes very weak (Grimm & Günther, 2007; Böhme & Thiele, 2012).

Nonetheless, Adele et al. (2015) specifically argue that informal competition allows for better utilisation of unused or underused economic resources. They also claim that it is the well-to-do and affluent people who often can mobilize resources for entrepreneurial processes. Therefore, they make informality look like more of a matter of choice because exploiting business opportunities requires the deployment of physical and human resources that may be beyond the reach of the poor. They also explain that formal enterprises that are more open to informal competition are more likely to boost their productivity to overcome informal enterprises' cost advantages. One of their evidence shows that the amount of

taxation that determines differences in cost between formal and informal enterprises represents the main channel through which positive effect could occur.

Williams and Martinez-Perez (2014) similarly opine that informal enterprises are usually strong competitors because they can provide goods and services at lower prices, good quality, and timely. As informal enterprises are small and usually managed by a sole person, it is easy for them to communicate quickly using simple strategies. They also have more flexible production processes compared to formal ones. They usually move quickly where there is a demand and serve the market with new and less expensive products and services. Their labour organisation and internal management are easily adapted to new situations such as serving different and uncommon market or customers' demands (Saviotti & Pyka, 2008; Gülbiteń & Taymaz, 2000; Duchêne & Rusin, 2002). Therefore, informal enterprises' competitive advantage is mainly based on their creativity in adjusting or adopting new and peculiar managerial practices.

Research methods

This study took samples from the population of entrepreneurs and business owners operating informally from different market zones in Lagos, a mega-city in south-west Nigeria. It is Nigeria's largest and most populated city, bequeathed with several tourist attractions and fascinating landmarks that constitute holiday resorts and festive periods. The most famous districts encompass the old city on western Lagos Island, Ikoyi Island, Iddo Island, Apapa and a group of mainland suburbs, Ebute Metta, Yaba, Surulere, Mushin and Ikeja. A random sampling method was employed to classify informal entrepreneurs into micro-, small-, and medium-scale enterprises. We collected a total of 120 questionnaires from entrepreneurs, who had participated and had been operating in the informal sector since 2013. This was to ensure each had been operating for a minimum of five years. Stratified sampling procedure was employed to classify them into different business activities and a minimum of 10% participants was randomly selected to ensure equal proportional representation.

The distribution of the sampled participants in terms of Background Information are gender, age, ethnic groups, educational status and types of business. The age analysis of the sample shows that the respondents aged 12 to 18 comprise 8% of the total, those between 19 to 30 years 11.6%, then 31 to 40 years 57.7%, those 41 to 50 years 24.2%, while 50 and above 6.7%. In terms of highest relative number of the respondents, the age group of 31 to 40 years emerged as the highest, which shows that the sample is essentially composed of a relatively young population. Approximately 61% of the respondents are men and 39% are women. The sample shows a preponderance of the population of high school education 35%. About 30% of the participants have bachelor's degree, then 21.7% of them are National diploma or Advance levels owners, 10% have no formal education and 3.3% have the highest educational with master's degree. Yoruba have the highest population of respondents 62.5%, followed by the Ibo 30.8% and Hausa 6.7%. In all, the Yoruba has the highest percentage making them the largest Ethnic group. The majority of respondents are "Retail traders" with workforce of 20.8%, followed by the "Manufacturing" and "Transportation" sector 12.5 % of respondents. While the "construction" and "ICT" sector accounts for 10%. Finally, "Education" and "Finance" sectors are less represented with 8.3%.

Data obtained was analysed using inferential statistical tool of ANOVA to determine the impact of characteristics of entrepreneurs on informal entrepreneurship. The homogeneity of variance test (Levene) identifies the variables that can be the subject of an ANOVA analysis. This study led to the testing of the samples and made it possible to validate the different hypotheses as illustrated below.

Results and discussion

The study examined the characteristics of the informal entrepreneurs, explanations for operating informally, and entrepreneurial strengths of the informal economy in Lagos, Nigeria. The level to which identified factors impact the choice of informality for business owners was examined through the instrumentality of a structured questionnaire. However, we included the following characteristics of informal entrepreneurs and enterprise - duration of business, size of business, business registration. The ANOVA results of the study are presented below:

The ANOVA results of duration of business show that, exclusion by regulation (Levene= 4,245 $p=0,007$), registration of business (Levene=3,603 $p=0,016$), and impact of cost (Levene 1,943 $p=0,126$) do not verify the hypothesis of variances' homogeneity variables and ANOVA test. There is, however, an effect of duration of business on exclusion by job ($F= 2,119$ $p=0,102$), exclusion by education ($F=2,528$, $p=0,061$), financial assistance ($F= 271$ $p=0, 847$), and impact of cost ($F 452$ $p=0,716$). Since the Levene test rejects the assumption of homogeneity of variances, we conducted the Kruskal-Wallis test in alternative. The latter shows that there is an effect of duration (HLg OP Bus) on exclusion by regulation (KW 11,822 $p=0, 008$) and there is no effect of duration on registration of business (KW 5,531 $p=0,137$).

The ANOVA result on size of business shows that exclusion by regulation (Levene= 1,998 $p=0,072$), exclusion by job (Levene=3,977 $p=0,001$), and registration of business (Levene= 2,457 $p=0,029$) do not verify the hypothesis of variances' homogeneity variables and ANOVA test. There is no effect of size of business on exclusion by regulation ($F= 0,679$ $p=0,667$), exclusion by education ($F=1,610$, $p=0,151$), on financial assistance ($F= 0,356$ $p=0,905$ and impact of cost ($F= 1,470$ $p=0, 195$). Consequently, we conducted Kruskal-Wallis test, since the Levene test rejects the hypothesis of homogeneity of variances. Thus, there is an effect of the size of business on registration of business (KW 14,261 $p=0,027$), and on education by job (KW 16,153 $p=0,013$).

The ANOVA result of business registration shows that, exclusion by regulation (Levene= 6,659 $p=0,011$), registration of business (Levene=30,514 $p=0,000$), and financial assistance (Levene= 4,056 $p=0,046$) do not verify the hypothesis of variances' homogeneity variables and ANOVA test. There is, nevertheless, an effect of business registration on exclusion by job ($F= 14,104$ $p=0,00$), exclusion by education ($F=8,089$, $p=0,005$), and impact of cost ($F= 2,867$ $p=0, 093$). Since the Levene test rejects the assumption of homogeneity of variances, we conducted the Kruskal-Wallis test in alternative. The latter shows that there is an effect of business activities on registration of business (KW 50,785 $p=0,000$), and on exclusion by regulation (KW 3,585 $p=0,058$). There is no effect of business activities on registration of business on financial assistance (KW 025 $p=0,874$).

From the results above, all the identified characteristics have significant contributions to the choice of informality. The result shows that the duration of informality varies according to years. Those under 2 to 5 years have the highest informality rate; while it appears that a high proportion of business for exclusion by job decreases when it is above 5 years. The result also shows a positive relationship between exclusion by education and business registration; therefore, there is a high level of informality in business registration. This indicates that informal entrepreneurship is driven by the choice of registering a business or not. Registration of business should, however, be noted as one of the criteria commonly used to determine if a business belongs to the informal sector. In Nigeria, the government uses CAC to differentiate formal from informal businesses. Registration discloses the relationships between household businesses and the state. Moreover, the results reveal that a large number of enterprises are operating in the formal sector by enterprise characteristics, but their business is informal in nature. They do not register their business. This indicates that

casualisation or the amount of contractual labour increases in the formal sector, which is a matter of great concern for policy makers.

Besides, findings showed people might involve in informal ventures because of various factors. These factors include unemployment, tax evasion, labour regulations, workers' preferences, and characteristics, and changes in workers' productivity in the formal sector (Chong & Gradstein, 2007). The reasons to engage in informal activity may be different for developed and developing economies. For instance, entrepreneurship in developing countries faces a higher regulatory burden than those in developed countries (Baharudin et al., 2011). Employees who are mostly unskilled in the respective sectors lose their jobs, and due to their low skill levels and incapability of moving to new activities that require training, they have no choice but to move into informal activities (Kasseeah & Tandrayen, 2014).

Based on the foregoing, we conclude that informal entrepreneurship characteristics encourage the informal entrepreneurs to achieve success. Factors such as duration of business,

size of business, and business registration can influence the entrepreneur to operate in the informal sector. Meanwhile, individual characteristics - personality traits, entrepreneurial orientation, and entrepreneurs' self-efficacy - encourage the informal entrepreneurs operating in the informal sector. In addition, being independent and having a positive mindset is also part of the informal entrepreneur's characteristics that motivate them to operate continuously in the informal sector (Ahmad, Ibrahim, & Ismail, 2011). However, facing challenges in the informal sector might cause some entrepreneurs to lose their motivation. As mentioned in previous research, it is imperative to improve the informal entrepreneur's characteristics in order for them to achieve a better performance in the informal sector.

Our opinion of the effect of formal criteria on informal firms' productivity reports a significant effect. Hence, through favourable government conditions, informal firms in Nigeria can have an entrepreneurial capacity that allows them to engage in an efficient relationship with legitimate firms and generate positive outcomes for the economy. Nevertheless, as underlined separately in many studies (Eifert et al., 2005; Ayyagari et al., 2008), we show that the underlined positive effect is segmented by formal firms' size, sector of activity, and current labour regulations. Larger firms operating in the service sector and facing less stringent labour regulations are more susceptible to boost their productivity by creating economies of scale and better allocating their resources (Amin, 2002).

Based on the above, we conclude that the informal sector encourages people for many reasons, and most of the reasons are similar, especially in developing countries. The most common reason is the economic downturn in the country, which usually leads to unemployment problems. When people do not have a job, they will be creative and find alternative ways to survive. Those who do not have a high skill or education and do not have a chance in the formal sector also choose to join the informal sector. Given the informal sector characteristics, many people join the sector to avoid living in poverty and gain income. Subsequently, non-payment of specific taxes, non-wage cost, and low labour regulations, unlike the formal sector rules, has encouraged the informal entrepreneurs' presence in the informal sector. Researchers also agree that the flexibility of time and freedom to operate in the informal sector motivates the informal entrepreneurs. Besides that, some informal entrepreneurs choose to operate in the informal sector as a hobby, which is only a part-time job.

Conclusion

Contrary to most of the studies focusing on the informal sector (Cling et al., 2010), our findings show that exclusion and institutional constraints significantly impact the

decision to engage in the informal sector. Institutional constraints are related to ambiguity in tax assessment, and business registration policies and procedures, including the mismanagement of powers by the government agencies. On the other hand, the individual choice and the role of official representatives are sources of institutional void in Nigeria's institutional context.

Our results further reveal that social exclusion in different ways influence the decision to engage in informal economic activities. First, the findings indicate that specific formal sector requirements such as formal education and training, inaccessible venture capital requirements, and minimum product quality standards constitute a source of exclusion that prompts individuals to choose informal business as an alternative mode of business engagement. This exclusion arises precisely because of the requirements of the formal sector. Second, at a more general societal level of analysis, social exclusion resulting from lack of access to services such as road infrastructure, electricity, water supply, security services, and other social services, was also found to be a vital reason underlying the decision to engage in informal economic activities.

Based on the foregoing, a number of recommendations can be offered. First, funding for informal entrepreneurs and Government resource support for microenterprises could better reflect the needs of the kinds of businesses more likely to opt for informality, while also exposing nascent entrepreneurs to other new venture opportunities (Omoloba & Estay, 2023). Second, strategy and implementation of intervention programmes aimed at promoting business start-ups and growth of existing ones should be scrutinised. We observed that government agencies responsible for discharging these functions could engender social exclusion through, for instance, unclear goal-definition and inefficient work processes. Most government intervention programmes in Nigeria are of the nature that exclude the majority of unemployed and underprivileged who have more need for such intervention. In most cases, the programmes themselves are selfishly designed to benefit corrupt government officials at the expense of the vulnerable people in the society. Third, both government and non-governmental agencies should increase the competitiveness of these businesses through appropriate measures such as business training and infrastructure improvements.

The current research is not without limitations. Despite our attempts to address the controversial questions about the Informal Sector. Although we generated a random sample, our sample size is relatively small and primarily urban. There is a need for larger samples that better capture the level of exclusion. For instance, the inability of entrepreneurs to meet the requirement of quality standards in the formal sector is found to have an impact on their decision to choose informal business. Likewise, lack of access to basic needs such as formal education can serve as a barrier to having access to the formal sector.

Conclusively, the findings in this study indicate that academics' role is of critical importance in the context of seeking to understand the crescendos of informal entrepreneurship. There is a need to investigate further how strategic information from formal institutions matter in informal entrepreneurs' decision process. There seems to be a whole lack of knowledge about official processes and business regulations (Egila, 2012). Finally, the emergence of post-modernism values such as the importance of environment and societal equality has allowed the informal enterprise to gain moral legitimacy by depicting itself against the backdrop of a capitalist system that focuses too heavily on profit orientation. Concurrently, informal entrepreneurs have also used the inherent success of the capitalist system, for its ability to efficiently distribute goods and services, to key onto models and values of the business to reap practical legitimacy. Yet, informal sector operators need to equip themselves with how institution void influences their decisions and better negotiate the social convention, which is currently not in their best interest. This can perhaps be achieved with the representative of trade unions and practitioners.

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