

# Entrepreneurship put to the test of the informal sector: what contribution in terms of formalization?

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## ABSTRACT

Entrepreneurship in the informal sector has become a very important global phenomenon and is attracting growing interest from researchers in management sciences. Indeed, its nature and its contribution to employment and socio-economic development vary according to the context in which it occurs. Moreover, there is no consensus on the nature of the impact of entrepreneurship in the informal economy and the answer to the well-known question: Should we encourage, ignore or oppose entrepreneurship? In the informal economy? In this regard, we are interested in this research in the analysis of the main determinants of entrepreneurship in the informal economy, as well as the repercussions it has on the economies.

## Key words

Entrepreneurship, informal sector, informal entrepreneurship.

## INTRODUCTION

Entrepreneurship is one of the most important forces shaping changes in economic conditions, whether they take place within the formal economy or informally outside the state regulatory system (Carree et Thurik, 2010 ; Thurik et al, 2002 ; Williams et Nadin, 2010, etc.). Indeed, entrepreneurship in the informal economy has received little attention from academics, but there are a number of reasons why it should not be ignored. First, informal trading activities account for a large share (on average more than 30%) of global economic activity (Schneider et al, 2010). Second, entrepreneurship in the informal sector exists in all countries, regardless of their level of economic development (Thai et Turkina, 2012). Third, informal economy entrepreneurship is strong in some countries. Fourth, entrepreneurship in the informal sector can be exposed to unethical practices (corruption, exploitation of workers, and abuse of the natural environment...). It is therefore very important to understand the motivations of entrepreneurs to create new businesses in the formal and informal sectors and to study the repercussions of this type of entrepreneurship on the socio-economic development of countries.

Our research consists of presenting an inventory of entrepreneurship but also identifying potential actions and its contribution to the development of the informal sector in terms of formalization. Hence the formulation of our problem in the following main question:

« **To what extent does entrepreneurship allow the transition from formal to informal? »**

From this central issue, we decline a number of questions that we will try to answer throughout this study:

- What is entrepreneurship?
- What is entrepreneurship in the informal sector?
- What are the basic principles of informal entrepreneurship?
- What is the link between entrepreneurship and the informal sector?

## 1. Literature review on entrepreneurship

The expression social economy appears for the first time at the beginning of the 20th century and precisely in 1912, in a work entitled "the institutions of social progress" whose author is Charles GIDE. From the mid-1970s, and especially from 1980 (beginning of the application of structural adjustment programs in several countries), we witnessed the emergence of a set of solidarity economy practices.

### 1.1 Emergence of entrepreneurship

At this level we try to discuss the question of the entrepreneurial phenomenon, as well as a critical paradigmatic reading of the field of entrepreneurship. A paradigm is a theoretical construction subject to the support of a sufficiently significant part of

the researchers who, within the community, share the point of view proposed by the paradigm (Vesrtaete et Fayolle, 2005) who believe that entrepreneurship is too complex and too heterogeneous a field to be limited to a single definition.

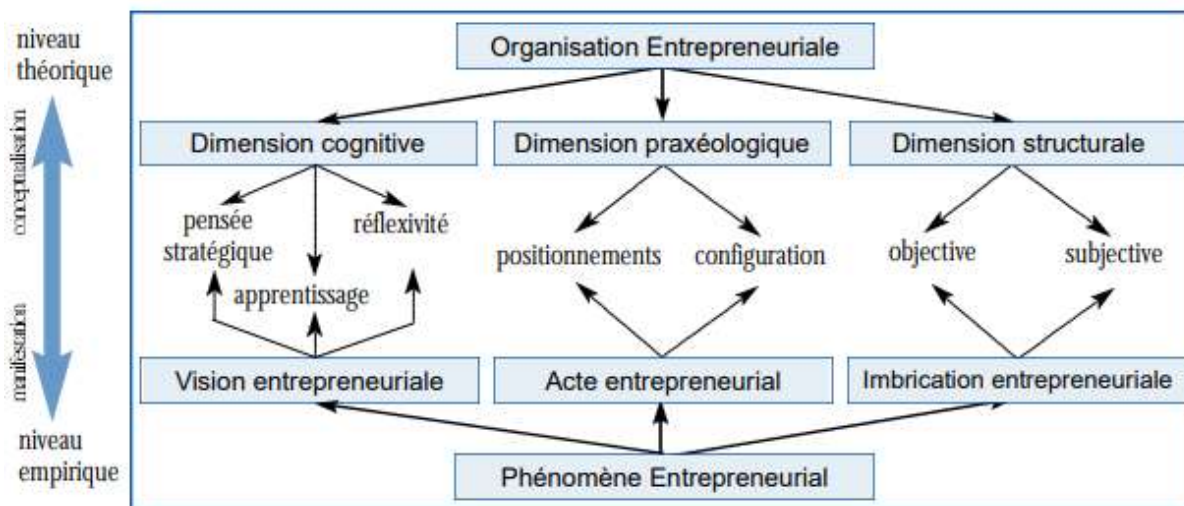
➤ **Paradigm of the creation of an organization**

For Gartner (1985), the appearance of a new organization is the consequence of a process of organizational emergence. This event is the very essence of entrepreneurship, and the object on which studies must focus. He also points out that he does not have a process but processes of emergence. The relevant components of the creation of new organizations in his model are: the environment, the individual, the firm and the entrepreneurial process. As variables characterizing its model, Gartner used three psychological variables: the propensity to take risk, the locus of control, the need for accomplishment (need of completion) and certain demographic variables (education, age, parent’s entrepreneurs...).

For Verstraete (2000), entrepreneurship is seen as a phenomenon leading to the creation of an organization driven by one or more individuals having joined for the occasion. Verstraete's definition is reformulated as the following equation:

$$\text{PhE} = f((\text{C.S.P}) \text{ included in } (\text{E.O}))$$

**Figure 1: Modelling of the entrepreneurial phenomenon (PhE)**



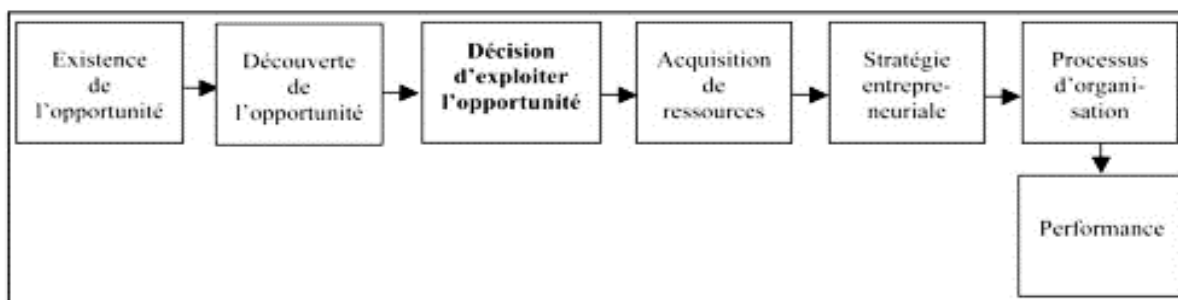
**Source: entrepreneurship: modelling the phenomenon (Verstraete)**

➤ **Opportunity Paradigm**

It was streamlined by Scott Shane and S. Venkataraman. This current of thought is interested in the notion of opportunity as the ability to create or identify opportunities and exploit them. In this conception, Shane and Venkataraman (2000) consider entrepreneurship as a subjective field of study that integrates two phenomena at once; the presence of a lucrative business opportunity and the presence of individual entrepreneurs who identify, discover and exploit this opportunity.

It is the most famous and the most recent paradigm in entrepreneurship, it is anchored in the fundamental works of Venkataraman (1997) and Shane and Venkataraman (2000) thus it takes its origin from marketing in order to meet needs not yet satisfied in the market. So this is the dominant paradigm.

**Figure 2: a linear model**



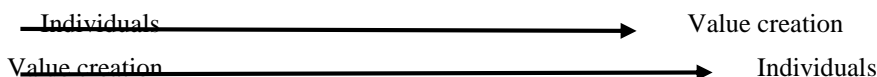
**Source: Adapted from Shane (2003, p. 251).**

➤ **Paradigm of value creation**

This approach defines entrepreneurship as a phenomenon or a process that creates value, whether individual, economic or social. Indeed Ronstadt (1984) has defined entrepreneurship as being “a dynamic process of creation of an increasing value, this value is created by individuals who assume the major risks in terms of equity, time and/or career commitment to provide value for some

product or service. This in-service product may not be new or unique, but the value must be infused by the entrepreneur by sourcing and allocating the necessary skills and resources.”

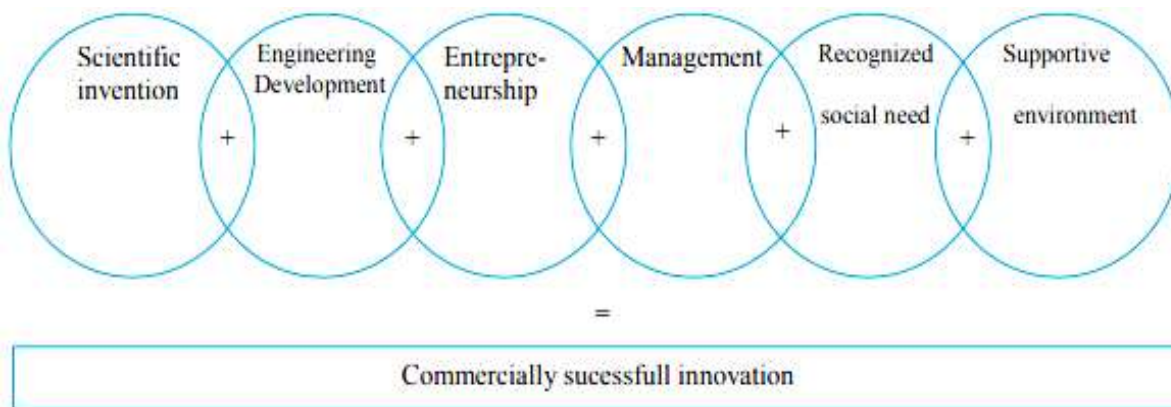
Bruyat (1993), proposes a field of entrepreneurship and affirms in this respect that the individual is a necessary condition for the creation of value, he determines the methods of production, the extent... he is the main actor. The support of value creation, a company for example, is the “thing” of the individual, we have:



**Paradigm of innovation**

In line with the work of Schumpeter (Chapter 3, on entrepreneurship and the economy), this current attaches great importance to innovation in the definition of entrepreneurship. Drucker (1985) followed Schumpeter in distinguishing between administration and entrepreneurship and defining innovation as a means by which entrepreneurs can exploit change to create a new service or business opportunity, thus he views it as a condition of value creation. For Carland et al (1984), innovation would also make it possible to differentiate entrepreneurs from owner-managers of SMEs (chapter 2, on the entrepreneur). Julien and Marchesnay (1996), joins Drucker when he asserts that “innovation is the foundation of entrepreneurship...” Martin (1994), entrepreneurship can be reduced to one step in a larger process.

**Figure 3: the innovation chain equation**



**Source: Thierry Verstraete and Alain Fayolle**

### 1.2 The business model, an effective tool for characterizing entrepreneurship

The business model can be defined as being an effective tool for characterizing the company, something that makes it possible to retain whether company X is social or not, since the business model is the skeleton of a company. There are several business model canvases, but we will focus on Alexander Oster alder’s, which is the most complete. Alexander is a Swiss entrepreneur and researcher, author of the book: “Business Mode: new generation”, with Yves Pigneur.

This business model encompasses nine dimensions, namely;

- Value proposition: it is the contribution of the organization to that target, that is to say the added value as well as the strengths compared to the competition.
- Customer segmentation: for each product or service, what will be the targeted customer segment?
- Distribution channels: i.e. where will the product be sold?
- Customer relations: communication with the customer or customer reception.
- Sources of income: income can come from direct sales or through the rental of premises.
- Key resources: the human, financial and material resources that are necessary to launch the project.
- Key partners: does the organization need external service providers to promote these products.
- Main activity: what needs to be put in place for the proper functioning of the project.
- Cost structure: what are the different types of cost that the project requires.

## 2. Entrepreneurship in the informal sector

The field of entrepreneurship has evolved from the perspective of different schools. Each brings an additional understanding of the phenomenon, based on the premises of its own discipline.

### 2.1 Definition of entrepreneurship in the informal sector

Classical theories of entrepreneurship and management traditionally have little to say on the issue of the informal economy (Ram et al, 2017). The informal economy is made up of economic activities and entities that are not registered with the State and of workers who do not benefit from social protection through their work, whether they are employees or self-employed according to OECD (2017).

The definition of entrepreneurship in the informal sector was the subject of several research works aimed at understanding this complex concept. However, the efforts of the authors did not result in conceptualizing a precise universal definition of the concept of entrepreneurship in the informal sector. In this sense we are interested in the analysis of several significant definitions in the literature in order to understand this concept and we present in the following table a set of definitions proposed by authors of the concept of entrepreneurship in the informal sector:

**Table 1: Definitions of entrepreneurship in the informal sector**

<b>Auteur/ organisme</b>	<b>Définition de l'entrepreneuriat dans le secteur informel</b>
<b>OCDE (2002)</b>	All legal production activities deliberately concealed from the authorities to avoid paying income, value added or other taxes; to avoid paying social security contributions; to avoid complying with certain legal standards such as minimum wage, maximum working hours, safety or health standards...
<b>Cross (2000)</b>	The production and exchange of legal goods and services involving the absence of proper business licenses, violation of zoning regulations, failure to report tax liabilities, failure to comply with labor regulations on contracts and working conditions, and/or the absence of legal guarantees in relationships with suppliers and customers
<b>Portes et al. (1986)</b>	The sum of income-generating activities outside of modern contractual production (and distribution) relationships, which includes direct subsistence production, small-goods production, and trade by self-employed individuals for the market and unregulated small-scale enterprises under contract to large modern enterprises
<b>Autio et Fu (2015)</b>	an informal entrepreneur is a person who is actively involved in running a new business that sells legitimate goods and services and is not registered with official authorities

**Source:** The authors

Informal entrepreneurs are therefore those who start or own/manage a business that is older than 36 months and who engage in monetary transactions that are not reported to the state for tax, benefit and/or labor law purposes, when they should be. Thus, the only illegal aspect of their business is that they do not report all or part of their monetary transactions when exchanging legal goods and/or services. Indeed, entrepreneurs' decisions about whether to operate informally or formally are influenced by a myriad of factors (Webb, Bruton, Tihanyi, & Ireland, 2013).

## 2.2 Typology of entrepreneurship in the informal sector

Enterprises in the informal economy can be either totally informal enterprises or registered enterprises that conduct part of their transactions informally. The following table illustrates a typology of informal entrepreneurial activities according to the volume of informal activity in the overall activity of the enterprise and the time horizon of this informal activity.

**Table 2: Typology of entrepreneurship in the informal sector**

<b>Informal entrepreneurial activity</b>	<b>description</b>	<b>Intention to formalize</b>
<b>Total and permanent</b>	Operation of unregistered businesses entirely in the informal economy	No intention to formalize in the foreseeable future
<b>Total and temporaire</b>	Operating unregistered businesses in a totally informal manner	An intention to formalize
<b>Partial and permanent</b>	Operating businesses registered and paying taxes but not declaring part of their income	No intention to increase the share they declare
<b>Partial and temporary</b>	Registered businesses in operation that do not declare part of their income	Intend to transition and who are transitioning to the formal economy

**Source:** OCDE (2014)

## 2.3 Theories of entrepreneurship in the informal sector

### 2.3.1 Institutional theory

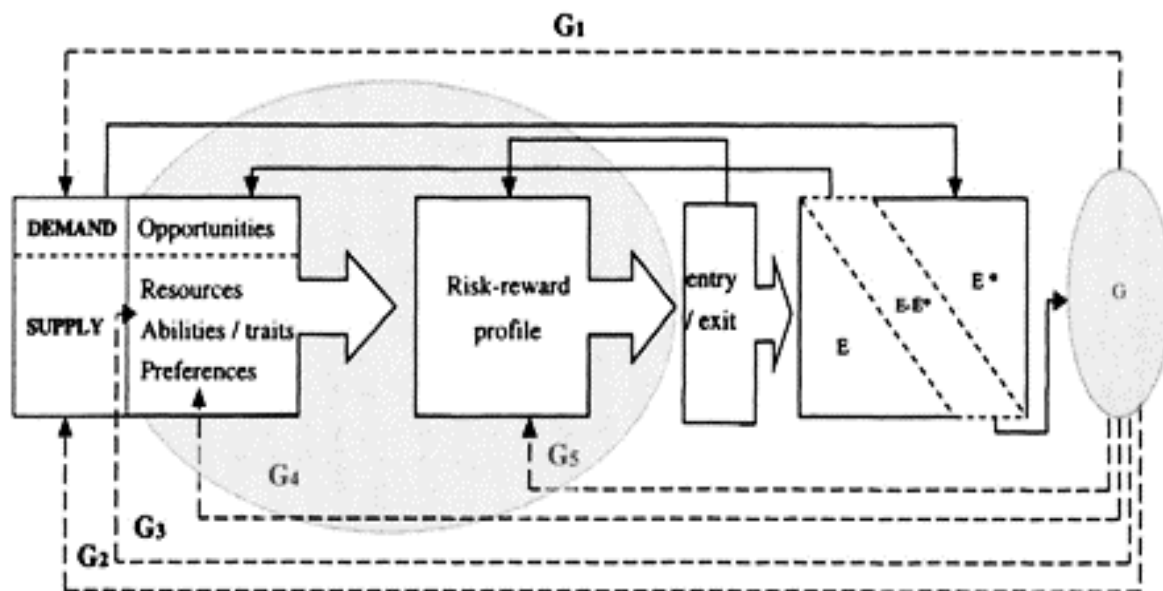
Institutional theory argues that systems and institutions influence the behavior of individuals and firms without necessarily mobilizing or intervening in response to expectations (Clemens and Cook, 1999). North (1990) divided institutions into "formal

institutions", such as laws, regulations and their supporting devices, and "informal institutions", such as social norms, values and beliefs. Formal and informal institutions define "generalized perceptions or assumptions that the behavior of entities within these formal and informal rules is desirable, correct, or appropriate" (Suchman, 1995, p. 574). By defining opportunities and facilitating interactions between actors, institutions promote socially acceptable behavior and outcomes through a system of constraints and incentives (Clemens and Cook, 1999).

### 2.3.2 Electrical theory

The eclectic theory of entrepreneurship was first proposed by Verheul et al, (2002) with the aim of developing a theoretical framework representing the determinants and explanatory factors of the level of development of entrepreneurship from the points of view macro and microeconomic in a given country. The figure below shows the theoretical framework of this theory:

**Figure 4: The Electrical Theory of Entrepreneurship**



Source: Verheul et al, (2002)

In general, the eclectic theory considers that entrepreneurs play a role in regulating supply and demand in the economy (Cantillon, 1959; Knight, 1971). Thus, entrepreneurs are agents who take risks and respond to economic opportunities in an ever-changing world, thus acting as tightrope walkers in the economic system (Kirzner, 1973; Schultz, 1975).

### 3 Contribution of entrepreneurship in terms of formalization

There is growing evidence that entrepreneurship in the informal sector brings not only monetary but also non-monetary benefits to many people. Evidence of this can be found in the study by Perry et al. (2007) on Argentina, Colombia, Bolivia and the Dominican Republic, where a large proportion of the informal self-employed cite as the main reasons for their informal activity the fact that self-employment provides them with higher income, offers more great flexibility (especially for women) and is a source of satisfaction. In developed economies, Blanche Flower and Oswald (1998) find similar entrepreneurial motivation for the self-employed in the UK, US and Germany.

Morduch (1999), for example, reports studies showing that informal insurance plays an important role in reducing the impact of income shocks. Finally, some informal jobs provide training opportunities that are particularly valuable for uneducated young workers. Indeed, the training can increase their chances of obtaining a formal job afterwards. Overall, the reasons for informal employment are clearer than their costs. The reasons for informality vary from country to country, but countries with a large informal sector have some commonalities. These include a set of rigid and cumbersome regulations and procedures, low levels of productivity among informal workers (whether self-employed or salaried), poor public service delivery and low levels of trust in public institutions.

Indeed, entrepreneurship in the informal sector plays a considerable role in the socio-economic development of countries, especially those in the process of development. The advantages of this type of entrepreneurship are multiple and touch on different aspects, these are mainly poverty reduction, the creation of job opportunities, the integration of the disadvantaged population into the country's overall economy. (Berrou, J. 2014).

However, entrepreneurship in the informal sector also has negative repercussions on the economies of countries, etc. among the main negative impacts of this type of entrepreneurship are the escape of a large amount that the state could have collected through

the taxation of business income and employees in the informal sector, also, employees in the informal sector are not protected and do not have social coverage and they face the risk of unfair dismissal.

## Conclusions

There are no two opinions on informal entrepreneurial activity, they are condemned on all platforms and in all societies. In fact, entrepreneurship in the informal sector exists in all societies and all parts of the planet. The objective of our study was to analyze the determinants and motivations that push entrepreneurs towards the informal sector and to examine the main impact of this type of entrepreneurship on the transition from informal to formal.

In fact, the main determinants of entrepreneurship in the informal sector fall into two categories: the first group includes the factors of need, necessity and obligation, the "push" category, while the second includes the factors related to the attractiveness of the informal sector, in particular linked to cost reduction, tax exhaustion, etc. Thus, through our scientific article, we deduce that:

- The determinants of entrepreneurship in the informal sector are mainly need, necessity, and an alternative strategy for survival.
- The informal sector contributes significantly to the GDP of countries.
- Entrepreneurship in the informal sector contributes considerably to the creation of job opportunities.
- The limits of entrepreneurship in the informal sector are mainly related to the risk uncertainty and the lack of social security and the instability of demand.

In conclusion, we emphasize that entrepreneurship in the informal sector has several advantages for countries, allowing them to improve their socio-economic performance. However, this also has a negative impact on the population operating there. Therefore, it is necessary to consider the development of mechanisms and strategies to integrate entrepreneurship from the informal sector into the formal sector in order to benefit from it without suffering its negative impacts.

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