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# Enabling Enterprise

**Tackling the Barriers to Formalisation**  
**Evidence Evaluation and Policy Implications**



**By Prof C.C. Williams, Dr S. Nadin, A.P. Barbour, Dr M. Llanes**

# Enabling Enterprise: Tackling the Barriers to Formalisation

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## Community Links

Our purpose is to champion social change. We pioneer new ideas and new ways of working locally and share the learning nationally with practitioners and policy makers. As a result, we are recognised as national leaders in regeneration and social policy.

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## Confidentiality and Anonymity

To protect confidentiality and ensure anonymity all names of those who have been involved in this research have been changed.

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## A note about our funder, The Institute of Small Business and Enterprise (ISBE)

The ISBE Research and Knowledge Exchange (RAKE) Fund provides financial support to new research activities from academics, third sector organisations, consultants and practitioners. The fund was created with the aim of assisting the exploration of issues, challenges and opportunities surrounding entrepreneurial activities and small firm performance and to encourage and promote cutting-edge research which is relevant to both the development of policy and practice.

Sponsored by Barclays, Economic and Social Research Council and National Council Graduate Entrepreneurship and launched in 2009, the fund has a call for applications each spring. Visit: [www.isbe.org.uk/RAKEFund](http://www.isbe.org.uk/RAKEFund)



## Summary

### Introduction

This report details the findings from a study of informal entrepreneurship funded by the Institute for Small Businesses and Entrepreneurship (ISBE) and conducted by the University of Sheffield in collaboration with Community Links.

The overall aim of the study was to advance our understanding of informal entrepreneurship and to provide recommendations as to how informal entrepreneurial activity can best be formalised. By formalisation we mean the process by which informal work becomes compliant with employment tax and benefit laws. Based on a combination of desk-based and empirical research, along with consultation workshops involving experts from the UK and Europe, this report provides an up to date synopsis of current knowledge relating to informal entrepreneurship.

The empirical data develops this understanding further, highlighting the varied forms of informal entrepreneurship as well as the varied motives underpinning involvement in such activity. It is against this more nuanced understanding of informal entrepreneurship that policy responses are reviewed drawing on case study examples from across Europe.

We conclude that the multifarious nature of informal entrepreneurship and the challenges this presents in terms of tackling it, demands greater cooperation and coordination from different stakeholders. We therefore recommend that a Hidden Economy Expert Group be established with the aim of advancing our understanding of knowledge, policy and practice in respect of informal entrepreneurship.

### What we know about informal entrepreneurship

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 and Laiglesia, 2009), the majority of whom work on a self-employed basis: 70% of all informal workers in sub-Saharan Africa, 62% in North Africa, 60% in Latin America, 59% in Asia (ILO, 2002b) and 77% in the European Union (Williams and Windebank, 2011).

This intimates that a large proportion of entrepreneurs in many global regions might operate in the informal economy. In spite of these figures, and reflecting on the literature as a whole, whilst the existence and practice of informal entrepreneurship is increasingly recognised, the various forms this may take, and characteristics associated with these different forms, is under explored.

Even less well understood are the motives behind involvement in informal entrepreneurship. Not surprisingly this is reflected in policy responses where the idea that 'one size fits all' tends to dominate.

### Tackling informal entrepreneurship: policy options

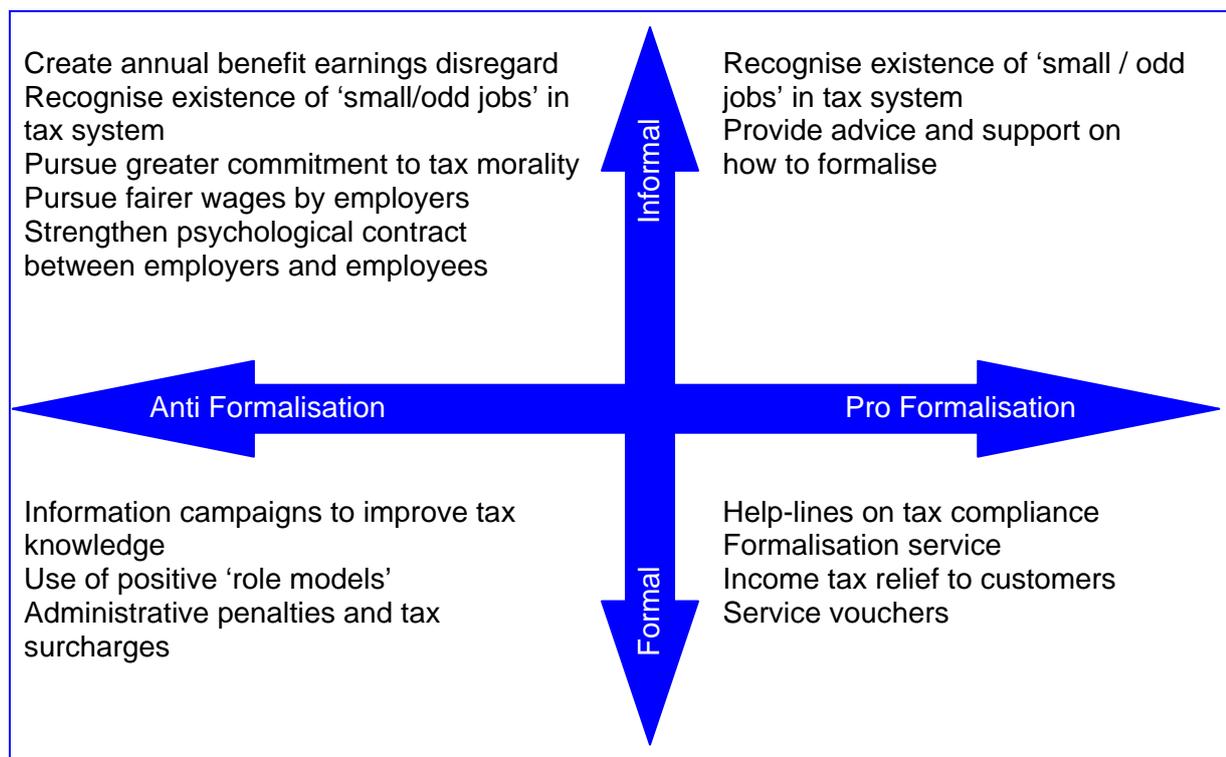
The related policy literature sets out a range of policy responses to tackle informal entrepreneurial activity. This reveals the existence of four different policy options, namely 'laissez-faire', 'de-regulation', 'eradication' and, 'facilitating formalisation'. From the evaluation of policy approaches provided in the literature review, it is obvious that neither a 'laissez-faire' approach nor a 'de-regulationist' approach should be pursued due to the negative overall impacts on the economic landscape. This leaves both the 'eradication' and 'facilitating formalisation' policy approaches as possible means of tackling informal entrepreneurship.

Based on interviews with informal entrepreneurs in east London, we evaluate these contrasting approaches taking into account both the nature of the informal activity and the participants' motives. Until now, the tendency has been to perhaps adopt a 'blanket approach' towards tackling informal entrepreneurs by treating all forms of informal entrepreneurship in a similar manner. This study, however, identifies four separate groups of informal entrepreneur, each of which witness different barriers to formalisation that need to be tackled using different policy measures.

These four groups are:

Type of Informal Entrepreneur	Description	Intention to formalise
Wholly Permanent	Operating unregistered enterprises wholly in the informal economy with	No intention of formalising in the foreseeable future
Wholly Temporarily	Operating unregistered enterprises wholly informally	An intention to formalise
Partially Permanent	Operating registered businesses and paying tax but not declaring a proportion of their income	No intention of increasing the share they declare
Partially Temporary	Operating registered businesses that do not declare a proportion of their income	Intention to and who are making the transition to the formal economy

Facilitating the formalisation of informal entrepreneurship appears to be the only viable option due to the overall negative impact of other approaches. Rationales for working informally and barriers to formalisation vary according to whether informal entrepreneurs operate partially or wholly 'off-the-books' and whether they view themselves as on a path of formalisation or not. Different policy measures will be therefore required for these different types of informal entrepreneur. Figure 1 summarises a range of bespoke policy measures required to tackle the barriers to formalisation and contrasting rationales for operating informally amongst the four types of informal entrepreneur identified above.

**Figure 1: Policy measures for tackling informal entrepreneurship**

None of these policy approaches fits neatly into a 'one size fits all' response, but rather require a more nuanced understanding of an informal entrepreneur's motivations and intentions resulting in a menu of interventions that can be tailored to meet their needs. To make this happen greater coordination and cooperation of all stakeholders involved in tackling the hidden economy is needed. Though this might be considered more difficult to implement by authorities it will ultimately ensure that more entrepreneurs operate in the formal economy.

We therefore recommend that a Hidden Economy Expert Group is established, bringing together those who have an interest and expertise in tackling informal entrepreneurial activity. This group should include government departments, employer and employee representative organisations, third sector organisations and academics with expertise in this field. As a consultative entity comprising a range of stakeholders the mission of the expert group is to facilitate greater coordination and cooperation of all stakeholders involved in tackling the hidden economy. The tasks of the platform shall focus on promoting and developing cooperation, developing expertise and capacity-building in order to improve the efficiency and effectiveness with which the hidden economy can be tackled.

To get involved in the Hidden Economy Expert Group please contact Professor Colin C Williams:

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## Introduction

In October 2010 the University of Sheffield in collaboration with Community Links were awarded a research grant by the Institute for Small Business and Entrepreneurship (ISBE) to study informal entrepreneurial activity and the barriers to formalisation.

## Aims and Objectives

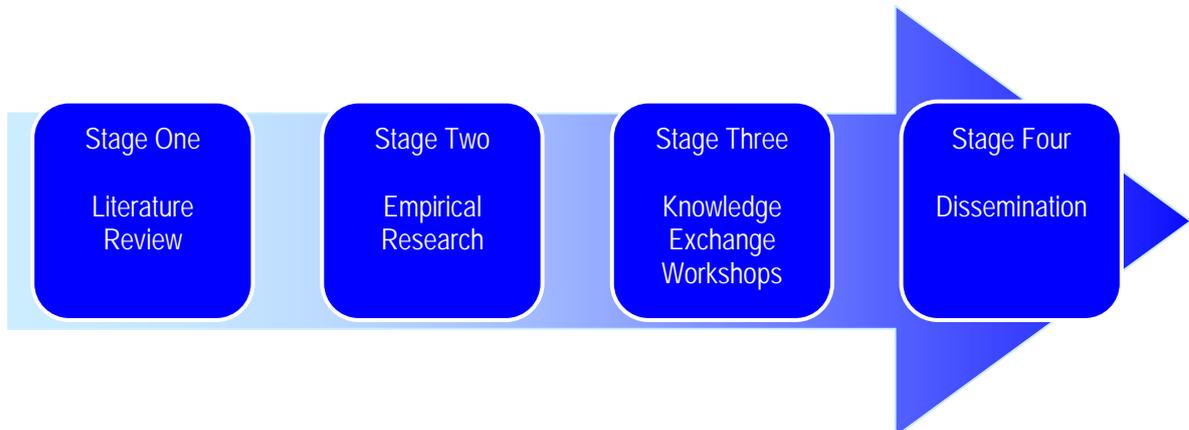
The aim of this project is to improve understanding of the barriers that hinder enterprises from making the transition from the informal to the formal economy, and how these might be tackled.

As the award is part of ISBE's Research & Knowledge Exchange Fund (RAKE), the objectives are to:

1. Collect evidence on the barriers that hinder enterprises from making the transition from the informal to the formal economy; and
2. Hold a series of knowledge exchange seminars to facilitate information exchange between high-level experts on potential policy solutions and the ways forward for public policy to encourage and support the formalisation of such entrepreneurial venturing.

## The Project

The project was conducted in four main stages with each stage feeding into the next:



**Stage 1** consisted of a desk-top review of existing academic and policy publications in the field of informal entrepreneurship and making the transition to the formal economy.

**Stage 2** involved empirical research which involved semi-structured interviews with 27 entrepreneurs in London engaged in informal entrepreneurial activity.

**Stage 3** comprised two 'knowledge exchange' workshops to facilitate information exchange between high-level experts on potential policy solutions and the ways forward for public policy to encourage and support the formalisation of such entrepreneurial venturing.

The first workshop had a European focus involving stakeholders and experts from a variety of European countries. Participants included European national government officials (from tax agencies, labour inspectorates and social security departments), trade unions, employer federations and 'think tank' representatives and academics.

The second workshop had a UK focus and again included a variety of stakeholders concerned with the informal economy including senior officials from government departments and agencies interested in tackling the informal economy and social partners (trade unions, HMRC, think tanks and employer federation representatives).

The outcome of both workshops was to gain a better understanding of the barriers that prevent informal enterprises from legitimising and the policy options that public policy can pursue to smooth this transition.

**Stage 4** will be to launch this report and disseminate its findings, and to ensure our recommendation to establish a Hidden Economy Expert Group in the UK is realised.

**A note about Confidentiality and Anonymity:** To protect confidentiality and ensure anonymity all names of those who have been involved in this research have been changed.

## Stage 1: Review of Existing Literature on Informal Entrepreneurship

Stage 1 involved desk-based research to review and synthesise for the first time the findings from previous studies conducted across the world on barriers to formalisation amongst enterprises. Of particular relevance were the practice / policy barriers and solutions that could be applicable to and replicable in the UK. Much of the literature on this subject is 'grey' literature existing in government department reports and academic working papers. The following is a synthesis of the review.

### What is the informal economy?

*'Informal work involves the paid production and sale of goods or services which are unregistered by, or hidden from the state for tax, benefit and/or labour law purposes, but which are legal in all other respects.'*

European Commission (1998)

In this project we have adopted the definition of the informal economy most commonly used (EU, 1998; Williams, 2006). The informal economy is here defined as the remunerated production and/or sale of licit goods and services not declared to the authorities for tax, social security and / or labour law purposes when it should be declared (European Commission, 2007; OECD, 2002; Williams, 2006). An informal entrepreneur, therefore, is somebody actively involved in business activity or is the owner/manager of a business (Harding et al. 2006; Reynolds et al. 2002) 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. Illegal or criminal activities such as drug dealing or prostitution have been excluded, as have exchanges of unpaid work.

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 and Laiglesia, 2009), the majority of whom work on a self-employed basis: 70% of all informal workers in sub-Saharan Africa, 62% in North Africa, 60% in Latin America, 59% in Asia (ILO, 2002b) and 77% in the European Union (Williams and Windebank, 2011). This intimates that a large proportion of entrepreneurs in many global regions might operate in the informal economy.

Given these figures it is perhaps not surprising that the past decade has witnessed a growing body of worldwide literature which sets out to explore entrepreneurship in the informal economy (Antonopoulos and Mitra, 2009; Bureau and Fendt, 2011; Gurtoo and Williams, 2009; Llanes and Barbour, 2007; Ram et al. 2007; Rehn and Taalas, 2004; Small Business Council, 2004; Valenzuela, 2001; Venkatesh, 2006; Webb et al. 2009; Williams, 2006, 2009). This emergent literature intimates that a large proportion of entrepreneurs conduct some or all of their transactions in the informal economy (Antonopoulos and Mitra, 2009; Llanes and Barbour, 2007; Rehn and Taalas, 2004; Small Business Council, 2004; Williams, 2006, 2009). Until now, however, few have estimated the proportion of entrepreneurs operating informally. One of the few studies to do so finds that 77% of

entrepreneurs interviewed in English localities operate informally, although this is more common in deprived and rural localities than in affluent and urban localities (Williams, 2010).

Whilst there is a growing recognition in the literature that informal entrepreneurial activity is immensely varied in terms of its extent and nature, few attempts have been made to unpack this complexity. On the rare occasions that informal entrepreneurs have been disaggregated into different varieties, such entrepreneurs have been differentiated firstly, by whether they trade wholly or partially in the informal economy and secondly, by whether they are pursuing formalisation or not (Katungi, Neale and Barbour, 2006; Llanes and Barbour, 2007; Williams, 2006). For example, the finding in one study of English localities was that just 20% trade wholly in the informal economy, although 31% do so in deprived localities but just 6% in affluent areas, and that around a half of all informal entrepreneurs are on a journey towards formalisation (Williams, 2010).

Reflecting on the literature as a whole, whilst the existence and practice of informal entrepreneurship is increasingly recognised, the various forms this may take, and characteristics associated with these different forms, is under explored. Even less well understood are the motives behind involvement in informal entrepreneurship. Not surprisingly this is reflected in policy responses where the idea that 'one size fits all' tends to dominate.

### **Tackling informal entrepreneurship: policy options**

Alongside the literature exploring the prevalence and nature of informal entrepreneurship is the related policy literature which sets out a range of policy responses to tackle informal entrepreneurial activity. This reveals the existence of four different policy options, namely 'laissez-faire', 'de-regulation', 'eradication' and, 'facilitating formalisation'. These are briefly summarised and evaluated here. In the context of this study it is the 'eradication' and 'facilitating formalisation' approaches which are of most relevance as reflected in current policy practice and future policy recommendations within the UK.

#### **Laissez faire**

One option is to 'do nothing'. The rationale is that informal entrepreneurship represents a seed-bed for new enterprise creation, a breeding ground for the micro-enterprise system and a test-bed for fledgling businesses and should therefore be left alone. The problem with this approach is that informal entrepreneurship has negative impacts on formal businesses, those working informally, customers and governments.

Formal businesses witness unfair competition from such enterprises and force them into the informal economy to compete, thus encouraging a 'race to the bottom' away from regulatory compliance (Evans et al. 2006; Renooy et al, 2004; Gallin, 2001; Grabiner, 2000; Williams and Windebank, 1998). Informal entrepreneurs, meanwhile, lack access to health and safety standards, cannot build-up rights to the state pension and other contributory benefits, and access pension schemes, suffer a constant fear of detection and risk of prosecution, witness pressure to enter into exploitative relationships with the formal sphere, lack legal protection relative to formal businesses, and are unable to develop and grow due to

structural constraints with regard to gaining access to capital and securing the support available to formal businesses (Evans et al. 2006; Gallin, 2001; ILO, 2002a).

Customers, furthermore, find themselves without: legal recourse if a poor job is done; insurance cover; guarantees in relation to the work conducted, and certainty that health and safety regulations have been followed. Finally, and for governments, there is a loss of revenue for the state in terms of non-payment of taxes owed; they are unable to pursue social integration and mobility due to the lack of tax income available; there is a loss of regulatory control over the quality of jobs and services provided and if a significant segment of the population routinely engages in such endeavour, it may well encourage a more casual attitude towards the law more widely (Renooy et al. 2004; Williams, 2006). In sum, the negative impacts of doing nothing mean that interventions to tackle informal entrepreneurship are required.

### De-regulation

Another option is to de-regulate the formal economy (Sauvy, 1984; De Soto, 1989, 2001). The objective is to give the market free reign by liberating it from external interference. As De Soto (1989: 255) asserts, 'the real problem is not so much informality as formality'. The view, as Castells and Portes (1989: 13) put it, is that 'in an ideal market economy, with no regulation of any kind, the distinction between formal and informal would lose all meaning since all activities would be performed in the manner we now call informal'.

However, this approach assumes that de-regulation reduces informality. Yet there is growing evidence that de-regulating does not formalise the economy (Kus, 2010). As Gilbert (1994: 616) argues, 'The hope that ... micro-entrepreneurs can go it alone, with a bit of credit and some deregulation, seems to be hopelessly optimistic'. Indeed, even if de-regulation were to do so, the outcome appears to be greater social polarisation and poorer quality work conditions (Peck 1996). One can thus only agree with Peck (1996: 2) that 'the hidden hand of the market is not an even hand' and that the result seems to be a levelling down rather than up of working conditions (Williams, 2006). In sum, even if de-regulation was to reduce the magnitude of informality, the impact would be to widen inequalities and reduce working conditions compared with more regulated states.

### Eradication / Deterrence

When pursuing intervention, one option is to seek to eradicate informal entrepreneurship. If informal entrepreneurs are viewed as 'rational economic actors' evading tax because the pay-off is greater than the expected cost of being caught and punished (Allingham and Sandmo, 1972), then the cost/benefit ratio confronting those engaged or thinking about participating in informal entrepreneurship can be changed (e.g. Grabiner, 2000; Richardson and Sawyer, 2001). This can be achieved by concentrating on the cost side and increasing the perceived or actual likelihood of detection (not least by improving the coordination of strategy, operations and data sharing) and the penalties and sanctions for those caught.

Whether this 'negative reinforcement' approach that seeks to elicit behaviour change using 'sticks' that punish those engaged in 'bad' behaviour is practical and desirable is questionable. Although some find that improving detection and/or penalties reduces

informality (De Juan et al. 1994; Slemerod et al. 2001), others identify that informality grows (Bergman and Nevarez, 2006; Murphy, 2005). Indeed, some even conclude that 'it is not sensible to penalise illicit work with intensified controls and higher fines' (Schneider and Enste, 2002: 192). This is because it can alienate informal entrepreneurs, decreasing their willingness to comply and amplifying informality by reducing their belief in the fairness of the system (Murphy, 2005).

Eradication is also perhaps not desirable. Given how informal entrepreneurship is a breeding ground and seedbed for entrepreneurship, seeking its eradication stamps out precisely the entrepreneurship and enterprise culture that governments otherwise wish to nurture. The resulting challenge for government is to 'join-up' its policies towards the informal economy and entrepreneurship. Unless this is done, governments will in eradicating the informal economy destroy the entrepreneurship and enterprise culture that they desire.

### **Facilitating formalisation**

There is growing recognition amongst governments that rather than seeking to eradicate informal entrepreneurship, another option is to facilitate its formalisation (European Commission, 2007, Dekker, Oranje, Renooy, Rosing and Williams, 2010; Renooy *et al.* 2004; Small Business Council, 2004, Williams, 2006; Williams and Renooy, 2009). In this report, we define 'formalisation' simply as the process by which informal work becomes compliant with employment, tax and benefit laws. This views individuals not as 'rational economic actors' but as 'social actors' who are ordinarily inclined to comply with the law, partly because of their belief in the rule of law, and partly as a matter of long-term self-interest (Murphy, 2005). As such, their cooperation rather than coercion is pursued. The role of government, in consequence, is less to act as a strict law enforcer which punishes 'bad' behaviour and more as a service provider to secure cooperation (Murphy, 2005; Williams and Renooy, 2009).

### **How, therefore, might this be achieved?**

Firstly, preventative measures can be adopted to prevent informality from the outset. This might include: simplifying regulatory compliance; introducing new categories of formal work; the provision of business support and advice; direct and indirect tax incentives, and the development of initiatives to smooth the transition to self-employment (Williams and Renooy, 2009).

Secondly, curative measures can be used to help those already participating in informal entrepreneurship to transfer into the formal realm. These measures include: offering amnesties on either a societal or individual level to informal entrepreneurs who put their affairs in order; offering business advisory and support services to those formalising their business ventures; and providing a range of targeted direct or indirect tax incentives encouraging customers to use formal rather than informal enterprises (Williams and Renooy, 2009).

Thirdly, commitment measures can be adopted to encourage an allegiance to formality amongst entrepreneurs and enterprises (Torgler, 2003; Williams, 2006; Williams and

Renooy, 2009). Such measures include tax education and awareness campaigns about the benefits of declared work, and the pursuit of perceived tax fairness, procedural justice and redistributive justice. Fairness here refers to the extent to which entrepreneurs believe they are paying their fair share compared with others (Wenzel, 2004), redistributive justice to whether entrepreneurs receive the goods and services they believe that they deserve given the taxes that they pay (Richardson and Sawyer, 2001) and procedural justice to the degree to which entrepreneurs believe that the tax authority has treated them in a respectful, impartial and responsible manner (Braithwaite and Reinhart, 2000, Murphy, 2005).

**Table 1: Policy approaches taken by governments**

Policy approaches taken by governments		
Approach	Method	Measures (examples)
Deterrence / Eradication  (pursue & punish)	Improved detection	Data matching and sharing Joined up strategy Joint operations
	Increased penalties	Increased penalties for evasion
	Increase perception of risk	Advertising the penalties for informal working Advertising the effectiveness of detection procedures.
Enabling Compliance	Prevention (deter entry)	Simplification of compliance Direct and indirect tax incentives Smooth transition to self-employment Introducing new categories of work Micro-enterprise development
	Curative (encourage out)	Demand-side incentives (e.g. service vouchers; targeted direct taxes; targeted indirect taxes) Supply-side incentives (e.g. society-wide amnesties; voluntary disclosure; formalisation services)
	Fostering Commitment (retain in the formal economy)	Promoting benefits of formal work Education Peer-to-peer surveillance Tax fairness Procedural justice Redistributive justice

## Case Study and examples of policy approaches

### Deterrence approach

#### Box 1. Crossroads Bank for Social Security, Belgium

Measures to improve detection have been at the core of Belgium's policy for tackling undeclared work since the 1990s. e-government is an integral part of government strategy in this respect. An important step was the establishment of the so-called Crossroads Bank for Social Security (Banque Carrefour de la sécurité sociale/ Kruispuntbank van de Sociale Zekerheid, BCSS/ KSZ) in 1991. This bank constitutes the central hub in an electronic network integrating the back office functions of all social security institutions in Belgium and thus facilitates a range of initiatives targeting undeclared work.

Some of the main e-government initiatives targeting undeclared work include: the Social Identity Card (1991) that made undeclared work harder to perform; the Immediate declaration system (Déclaration Immédiate/ONmiddellijke Aangifte, Dimona) 2003), which requires employers to electronically inform social security services as soon as an employee joins or leaves the organisation; and the International Migration information system (Landenoverschrijdend Informatiesysteem Migratie Onderzoek Sociaal Administratief, Limosa) (2006), which requires the electronic and immediate registration of any activity by foreign workers in Belgium. Dimona and Limosa have further increased the likelihood of detection, although both measures have yet to be evaluated.

### Enabling Compliance

#### Box 2. On the Spot' Firm (Empresa na Hora), Portugal

In 2005, the Ministry of Justice announced the Simplex programme, for administrative and legislative simplification. The 'On the Spot' firm is one initiative, which seeks to alleviate the processes and procedures necessary to set up a new firm. This initiative makes it possible to create a company in a single office (one-stop shop) and in a single day. Upon completion, the definitive legal person identification card is handed over, the social security number given and the company immediately receives its memorandum and articles of association and an extract of the entry in the Commercial Register. The security of the incorporation procedure for new enterprises is ensured by having all the details sent to the tax authorities.

Between 2005, when the initiative started, and September 2008, 59,068 new enterprises were created: 574 public limited companies (1% of the total), 34,934 private limited companies (59%) and 23,560 one-person companies (40%). The average time taken is 1h14m and the average set-up cost is €360. Whether such simplification has reduced undeclared work has not been directly evaluated.

Many other nations, nevertheless, are investigating the transferability of this initiative. After being recognised as a success by the World Bank, Angola and Cape Verde, for example, have already asked for legal and technical support and countries such as Slovenia, Hungary, Egypt, Mozambique, Chile, Brazil, Finland, Sweden or China have visited the 'on the spot firm' service to understand how Portugal has managed to simplify the procedures required for establishing a new firm.

It is against this backdrop of existing literature on informal entrepreneurship and associated policy responses that Stage 2 of the research was conducted. The aim was to explore the varied nature of informal entrepreneurship in an attempt to generate a more nuanced understanding, not only of the different forms informal entrepreneurship takes, but also of the motives behind engaging in informal entrepreneurial activity, in order to identify the perceived barriers to formalisation.

## Stage 2: Empirical Research

Stage 2 involved collecting evidence on the barriers that hinder enterprise from making the transition from the informal to the formal economy.

### Methodology

#### Collect evidence through interviews

A qualitative methodology was adopted using face-to-face interviews with 27 entrepreneurs who operate wholly or partially in the informal economy, either as small enterprises or on a self-employed basis.

The interview schedule (see appendix) was semi-structured and designed to elicit information in relation to:

1. The type, extent and importance of the informal work activity conducted
2. Motives and justifications for working informally
3. Perceptions of risk and ease of registering/operating formally
4. Socio-demographic background of the entrepreneur

### Sample

The sample was obtained using snowball sampling techniques through Community Links networks in London, with access being negotiated on an individual basis with service users. This approach has been used, in relation to informal work, by Williams et al over some 15 years in various locality-types and different nations (e.g. UK, Ukraine, Russia), and Community Links over the last 10 years in the UK. Interviews took place in the participants' homes, in neutral spaces, for example local cafes or parks, and over the telephone.

Table 2 provides details of the sample in terms of the sector and number of participants engaged in that type of work.

### Ethics

Although this is classified as a 'sensitive topic' in ethics terms, conducting research on such sensitive issues is covered by the University of Sheffield code of practice and careful consideration has been given to the ethical issues arising. Together the University of Sheffield and Community Links have decades of experience in researching and working with this client group. Informed consent was sought for each interview. All participation was on a voluntary basis and all responses have been anonymised to ensure confidentiality.

### Analysis

The interviews were recorded (audio/written), using a topic guide to ensure consistency. Data collected during the interviews and the seminars (see below) was anonymised. The data was kept securely in files with restricted access. Summaries of the information were then transferred to Word documents for analysis. The interviews were analysed using a thematic analysis to draw out common themes, concentrating on the barriers to formalisation, as well as some of the contextual elements.

**Table 2: Sample Profile - summary**

Profile	No.
Domestic services	
Cleaner	4
Childminder	4
Ironing	1
Clothes alterations and baking	1
Odd jobs	1
Gardener	1
Painter and decorator	1
Personal services	
Hairdresser	1
Beauty advice and sales	1
Personal trainer	1
Dog grooming parlour	1
Creative industries	
Documentary film maker	1
Sign writing	1
Software developer	1
Craft accessories and sales	1
Import / export sales	
Jewellery importer	1
Import / export goods	1
Other	
Forestry and fencing	1
Copy and sale Of CDs	1
Waitress*	1
Fast food catering	1
	N=27

\*informal employee

### Stage 3: Knowledge Exchange Workshops

Having established an understanding of the barriers to formalisation through the literature review and interviews, Stage 3 involved hosting a series of focus groups/knowledge exchange seminars to share the initial findings from the research, garner feedback from the 'experts' attending, explore potential policy solutions and discuss the ways forward for public policy that encourage and support the formalisation of this entrepreneurial venturing.

The teams from University of Sheffield and Community Links developed a number of policy solutions that were then discussed at the two knowledge exchange seminars.

The first seminar had a **European-wide** focus. It was hosted over two days in December 2011 by the University of Sheffield in London. It was attended by European national government officials (from tax/revenue agencies, labour inspectorates and social security departments), trade union federation representatives, employer federation representatives, academics and 'think tank'/third sector representatives.

The second seminar was **UK-focused**. It was hosted over one day in January 2012 by Community Links in London. It comprised senior officials from government departments and agencies with an interest in tackling the informal economy and social partner representatives (trade union, HMRC, employer federations, think tanks and third sector organisations).

### Relevance to ISBE / RAKE themes and knowledge exchange

This project links directly to the key theme of the informal economy addressing an area of high priority in terms of much needed research. By working in partnership with Community Links and the University of Sheffield, and directly involving high-level government officials with expertise, the project benefited from the pooled knowledge and skills of experienced researchers and practitioners in the field. In doing so, the aim was to produce a piece of research which demonstrates both academic rigour and real policy relevance. This partnership provides the foundation for further collaboration.

## Findings

### Tackling informal entrepreneurship: lessons from east London informal entrepreneurs

The findings show the varied nature of informal entrepreneurship in terms of the type, extent and motives for such activity. These have significant implications both in terms of current policy approaches to informal activity and for future policy recommendations. From the evaluation of policy approaches provided in the literature review, it is obvious that neither a 'laissez-faire' approach nor a 'de-regulationist' approach should be pursued due to the negative overall impacts on the economic landscape. This leaves both the 'eradication' and 'facilitating formalisation' policy approaches as possible means of tackling informal entrepreneurship. Here, we evaluate these contrasting approaches by learning lessons from the views of the informal entrepreneurs we interviewed for this project.

#### Lessons for the eradication approach

The eradication approach remains the dominant policy approach currently adopted by governments for tackling the informal economy. These interviews offer some valuable lessons for those who wish to continue to pursue such an approach. Whilst many of the participants knew what they were doing was risky and that they could be punished if they were caught, whether or not this acted as a deterrent varied. This was linked to the aspirations of the participants in terms of their ambitions for the growth of the business – the larger your business activities got, the more likely you were to get caught so the more sense it made to register (although this was not necessarily the sole reason for registering). Others struggled to see how they could make their businesses viable enough to offset the loss in benefits. Here, the fear of getting caught had the opposite effect and inhibited their business activities.

So, for some participants, therefore, fear of getting caught was one factor motivating them to formalise their activities, but this is not to suggest that all of their informal work ceased. The fear factor appears only to move businesses from being wholly off-the-books to partially off-the-books. Registering and declaring *some* of their earnings for tax purposes appeared to abate the fear of getting caught and legitimise their undeclared work activities, as long as they were paying some taxes (i.e. they paid enough tax as it was in their eyes).

This transition from wholly to partially off-the-books due to the fear of detection and punishment, however, was not universal. Many in the sample simply did not fear getting caught which was often explained with reference to the small scale nature of their undeclared work.

This has clear policy implications. The use of 'sticks' in the form of increasing the perceived probability of detection and the level of penalties for those caught has two contrasting effects. For some, it is one factor motivating them to register but for others, it is a factor inhibiting their entrepreneurial endeavour so as to ensure that they stay below the radar and do not get caught. This interacts with their low earning potential and the precariousness nature of the business, conditions which trap the incumbent into inaction for fear of losing their benefits. In the fear stakes, the fear of losing benefits appears to be a stronger

motivator (leading to a greater likelihood of operating wholly on an informal basis), than the fear of getting caught by the tax authorities (which leads to a greater likelihood of partial or full formalisation).

Overall, however, such a negative reinforcement approach will not help formalise most of these business ventures. For this to occur, policy measures are required to facilitate the formalisation of this informal entrepreneurial endeavour.

**Facilitating formalisation: towards a nuanced approach**

Until now, the tendency has been to perhaps adopt a ‘blanket approach’ towards tackling informal entrepreneurs by treating all forms of informal entrepreneurship in a similar manner. This study, however, identifies four separate groups of informal entrepreneur, each of which witness different barriers to formalisation that need to be tackled using different policy measures. The four groups varied according to the extent of their informal activity and their intentions in respect of formalisation. They are:

Type	Frequency	Basis	Description	Intention to formalise
Informal Entrepreneurs	Wholly	Permanent	Operating unregistered enterprises wholly in the informal economy with	No intention of formalising in the foreseeable future
		Temporarily	Operating unregistered enterprises wholly informally	An intention to formalise
	Partially	Permanent	Operating registered businesses and paying tax but not declaring a proportion of their income	No intention of increasing the share they declare
		Temporary	Operating registered businesses that do not declare a proportion of their income	Intention to and who are making the transition to the formal economy

The motives for each of these groups will be considered in turn.

*Motives/justifications of wholly off-the-books enterprises that had no intention of formalising*

Several participants stressed the necessity of not declaring their earnings in order to ‘make ends meet’ and ‘survive’, which was itself often linked to their reliance on benefits:

*Because I am single and I am on benefits and it is hard to make ends meet. It helps us to cover some of the necessities.*

*I think people do what they have to, to survive.*

The precarious nature of the informal endeavour acted as a further deterrence to declaring work activities when on benefits:

*I have no idea how much I would earn weekly. There are people some weeks and some weeks not many customers. If I am earning money one week would affect my*

*benefits and the other would be fine. It is too difficult at the moment. ....It is too complicated with my benefits and the uncertainty of having enough customers.*

For these participants, as well as potentially jeopardising their benefits, operating formally is perceived to be too costly due to taxes and childcare costs, leading to the conclusion that it is simply not worth it.

Three of the participants who did not intend to formalise their informal endeavour justified this with reference to the limited level of activity engaged in and the small amount of income generated:

*I only do it... not many days a year. It's time consuming to register as a company. I would lose money*

*No [I don't intend to formalise my business], it is too small. I have only used £300 to buy jewellery. The money here can buy lots of products in [country name]. If I can invest £1000, that would mean a big jump and I am still not sure that I would like to register ... I see it as a way to enjoy myself and get extra income that I can use, savings. I have not reached a point where I consider that I am doing something negative ... or dishonest. My business moves with me, it's a small bag with me.*

Two participants asserted that although they did work informally now, they would consider registering in the future, if they were to expand their business activities:

*I would if I put £15,000-20,000 in the business, then I would think of registering. I don't see it as a serious issue; it wouldn't become serious until I have premises.*

*It would get the social off my back .... At the moment I cannot get more customers cos' I can't advertise, but then I don't have all the paperwork at the minute.*

For these wholly off-the-books enterprises, therefore, the justification for working off-the-books tended to revolve around the limited income generated and the difficulties involved in declaring their enterprises whilst claiming benefits.

#### *Motives/justifications of wholly off-the-books enterprises who did intend to formalise*

Three entrepreneurs operated unregistered wholly informal enterprises but had the intention of formalising. 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 group above operating "parasitic" business ventures. However, his route to formalisation was to make the transition from employee to self-employment.

The two house persons operating wholly informally, 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 formalised 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 formalise in the future, especially if the business expanded and they took on additional employees.

### *Motives/justifications of registered enterprises operating partially off-the-books in a serial and ongoing manner*

Several participants operating registered enterprises also undertook off-the-books work in a serial and on-going manner. This involved not putting all of the business ‘through the books’ but otherwise being fully legitimate. Several approaches were adopted when doing this. For participant 1 (domestic cleaner), this meant declaring all income received up to the tax free limit. Anything above this limit was not declared in order to avoid paying tax. Another participant (software developer) simply only declared that part of his business for which he had to provide an invoice, and work for which he was not paid in cash.

*Some of my work I do cash in hand. It is easier not to have to account for everything and produce invoices and keep receipts for expenses when you are doing work for friends and people you know. For some of the work I do, people will slip me twenty quid or so and it feels inappropriate to supply an invoice and to include the work in accounts. A lot of the informal work I do is for small amounts – below £100. If it is a cheque and going into my bank account, then I have no alternative but to declare it. But if I’m paid in cash, I simply can’t see the benefit of declaring it. There is a big difference between being paid in cash or in other ways. Sometimes I work for small charities and they want to give me an invoice and paying by bank transfer and I always declare these payments in my tax return.*

Two participants (childminders) were formally registered with OFSTED although they did not put all of their earnings through the books simply by not declaring some of the children they looked after. In addition, one participant also had formal employment with an employer, reflecting the second pattern of formal/informal activities, i.e. those who were formally employed by an employer and engaged in informal work to supplement this formal income. A painter and decorator provides another example:

*I have already got a main job and I am paying taxes. What I am doing is just extra money and there is no need to register ... If I was doing this full time, and did not have my main job, and doing it 5 days a week I would register, but now it is not my main job now. If it were I would register.*

It was the participants in this category who provided the most detailed explanations in defence of their informal work activities, clearly laying the blame on the inadequacies or unfairness of ‘the system’ which rendered such activity a necessity:

*I think it is a shame that people have to go to these lengths to be able to cope financially, it should be better laws regarding employment, pay and conditions so*

*people choose this option instead of doing it unregistered or make a living on benefits ... It is not good for anyone, the person doing it is under stress of being caught and the government and the country lose out on money. So looser all around but as I said before it's the system that needs changing.*

Another participant emphasised the fact that she and her husband paid enough taxes as it was in a world where a lot of people got a lot of money for nothing. Whilst she knew that what she was doing was wrong, she felt justified in getting paid cash-in-hand for her child minding activities – it was her own informal ‘tax credit’.

*Of course, it is really important for us. We have two adult children who are at university and we do not get enough help to send them to university. They have bursaries which they loan and have to pay in the future. The cash in hand is of great help to us because we are supporting the two boys...I do genuinely think it is wrong and I might sound hypocritical. But my husband is in a high income bracket and we pay a lot of taxes. I take cash in hand and for me it is to support my children. Tax credits that no one else gets ... In the world we live in there are people who get a lot of money for nothing. If I take £100 per week I feel I deserve it.*

A further participant emphasised that this was not his main job (in which he did pay taxes), justifying his cash-in-hand work at weekends with reference to the stagnation of his wages over the past ten years and the need to maintain his wife's lifestyle.

*The money from my main work has not gone up much, even including bonuses. The bonuses has gone down and I am earning the same amount I was earning 10 years ago and my wife has got used to certain lifestyle. I have to do private work at weekends.*

On the issue of formally registering as self-employed, the process of registering was generally perceived as something which was very easy to do.

*It was easy enough as they want your money. One phone call and that was it.*

Registering as a company or a partnership however was a lot more troublesome. The software developer reported that it took half a day to complete the forms and 6-8 weeks to complete the registration process. A participant who did forestry and fencing reported similar difficulties.

Whereas registering as self employed was perceived as easy, actually maintaining accounts and filling in tax returns was reported by all these participants as both challenging and stressful:

*It was the right thing to do but a lot of hassle comes with it ... all the ridiculous amount of paper work and having to pay tax after every tax year ended, which can be hard to save up to as you don't know how much you will have to pay at the end of the year and if the money is there and you need it.*

The stress associated with the paperwork is reflected in the comments of those who described completing a tax return as ‘really scary’ (participant 7) and ‘hard going’

(participant 11). Similarly another participant explains the difficulties they faced in keeping formal accounts and the stress this caused:

*There's extra paperwork and stress when it comes to getting your tax return done. Neither of us has been used to doing this every year and it's taken a while to get used to doing it ... We write all our incomings and outgoing in one book. And once every couple of months we spend a morning or a day putting all the figures onto a spreadsheet, which then gives us the total at the end of the year. ... I'm getting used to the online tax return. It takes me a week of worrying about it – and then about a day to actually input the data onto the online system. I think I am going to use an accountant next year.*

It was these difficult experiences which filled them with dread at having to pay VAT should the business carry on growing such that their income exceeded the VAT threshold.

For these participants, therefore, a range of justifications were given for not declaring all of their income and there was a general feeling that keeping formal accounts was both challenging and stressful.

### *Motives/justifications of registered enterprises in transition to legitimacy*

For those who were formalising or had formalised their business activities, the key motive was in order to expand the business and gain access to new markets previously denied them when they were working on an undeclared basis. This is reflected in the comments provided by two participants who both emphasised the necessity of starting a business informally and then making a gradual transition to formality as the business progresses and grows:

*In general I think there are a lot of very successful businesses that started up informally for the first two or three years, but then registered with Inland Revenue and formalised. If you are concentrating on trying to get your business going you haven't got the time or the inclination to be doing your books as well. You would be spending more time on the books than on the actual business. If you start informally it's easier to experiment and take risks and try things out without having to invest too much money and you haven't made a public statement about your business. You can dip your toe in the water and see how it goes and then formalise it if it works. And that's what I've done. I know quite a few people who have done that. There's a chap here who does horse logging – pulling logs using a horse – and he started off doing the occasional job here and there and now they are registered and increasingly successful.*

*It [working informally] means you can take more money home but you lose legitimacy. When we were small it suited us, because you have to build up your portfolio and get connections. If we hadn't started small and cash in hand and informal we wouldn't have built up to where we are now and being able to register properly.*

Those who had fully formalised were very positive about having made the transition both in terms of the business generated and the positive sense of identity brought about by being a 'proper' business which had led them to be taken seriously:

*Also I wanted to be a legitimate proper normal business. I wanted to feel that I was part of mainstream society. I wanted to be seen as responsible and a serious business, so I could have a sign on my van and be up-front about what I was doing.*

*It [registering] has helped us enormously. The clients we are attracting now and approaching we could not have approached when we were working cash in hand. We need the formal company structure to be bona fide and have credibility. Also seeking funding from business start up sources and The Film Council and charities like UnLtd is only possible if you have registered with HMRC. We have applied to a number of these sources.*

Even a childminder who had avoided formalising because of the belief that she would risk losing her benefits and would therefore be worse off, reflected positively on her decision to formalise:

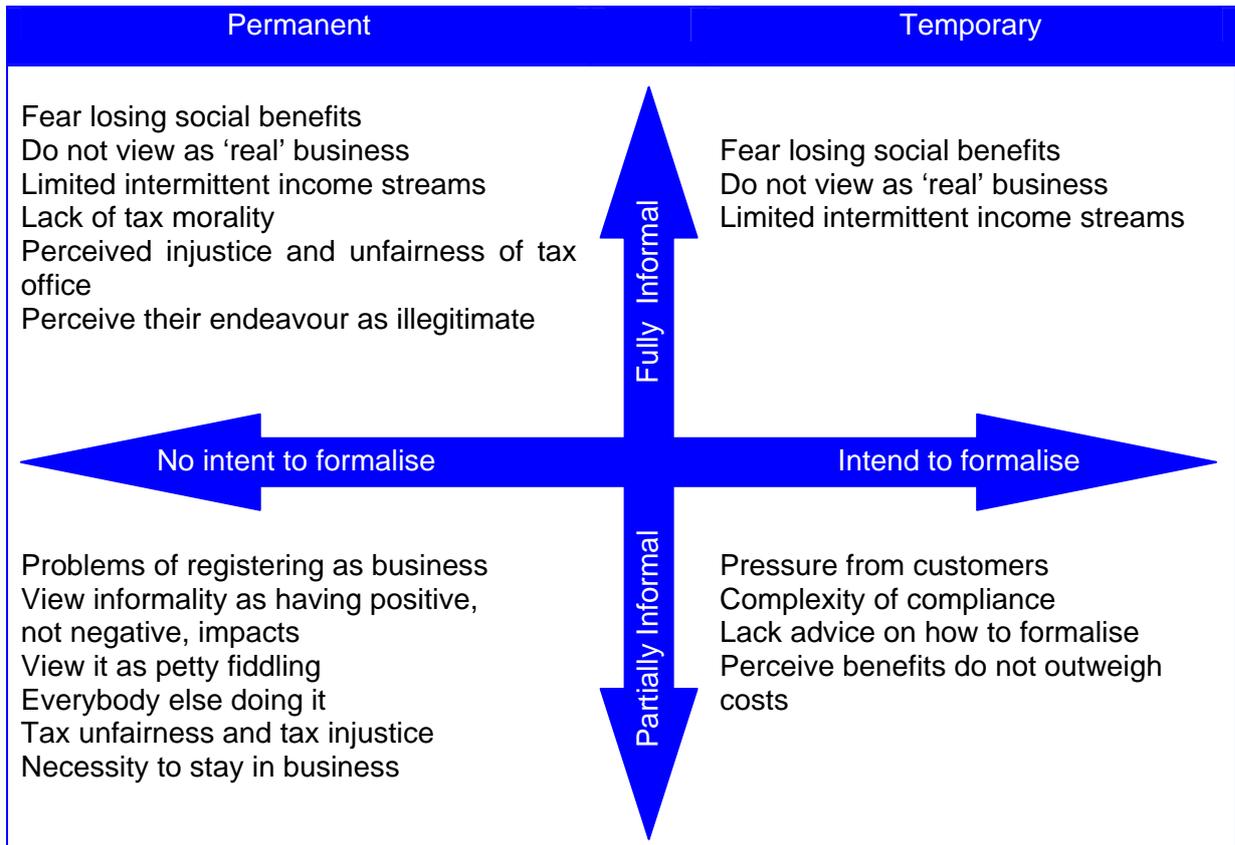
*I am not that worse off because of the tax credits. I am entitled to housing benefits. If I knew this at the beginning I would have done so sooner. It was lack of information*

For these participants, therefore, the transition to legitimacy had been, or is, a largely positive experience for their enterprises.

**Summary of interview findings**

Figure 1 summarises the interview findings concerning the reasons for operating informally for each of the four groups identified. As is shown, the different groups perceive different barriers which form the basis of the policy recommendations in the next section.

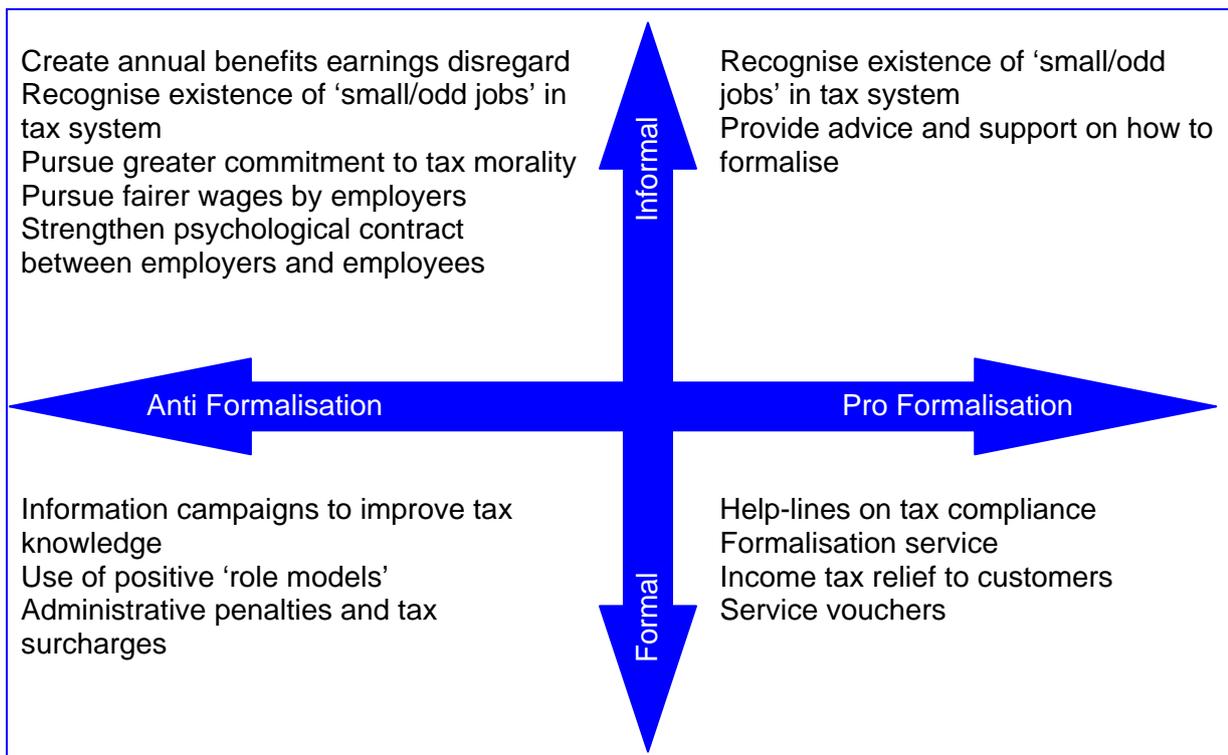
**Figure 1: Barriers to formalisation: informal entrepreneurs' reasons for operating off-the-books**



*Policy measures required to tackle informal entrepreneurship: by type of informal entrepreneur*

Given that facilitating the formalisation of informal entrepreneurship appears to be the only viable option, and that the rationales for working informally and barriers to formalisation vary according to whether they operate partially or wholly off-the-books and whether they view themselves as on a path of formalisation or not, different policy measures will be therefore required for these different types of informal entrepreneur. In other words, a tailored approach towards facilitating formalisation is required that tackles the specific barriers to formalisation confronted by these different segments of the hidden enterprise culture. Figure 2 summaries a range of bespoke policy measures required to tackle the barriers to formalisation and contrasting rationales for operating informally amongst the four types of informal entrepreneur identified above.

**Figure 2: Policy measures for tackling informal entrepreneurship**



**The following section unpacks each of the quadrant areas in Figure 2.**

*Tackling wholly off-the-books enterprise with no intention of formalising*

Analysing permanent wholly informal entrepreneurs, the finding is that most had not registered their enterprise or declared their earnings because they were uncertain about the viability of their enterprise, feared losing their benefits, and did not consider that they received sufficient in benefits to survive. To tackle such informal entrepreneurship, therefore, policy measures are recommended such as implementing an annual disregard for benefits recipients to formalise much of this endeavour and coupling this with measures to allow a gradual transition from benefits to self-employment, promoting greater commitment to tax morality through education campaigns, employers paying fairer wages and strengthening the psychological contract between employers and employees (Nadin and Williams, 2011).

To ease the transition from unemployment to self-employment, the UK government can learn lessons from many other countries. For example, in Germany, the *Ich AG* scheme gives unemployed people starting up as self-employed a monthly subsidy for three years. In the first year, they receive 50% of the average unemployment benefit level, 30% in the second year and 20% in the third and final year. A start up monitor shows that in 2003, over 93,000 long-term unemployed started a small business using this *Ich-AG* scheme. The German government expected around 20,000 start-ups to be launched (Renooy et al, 2004, Renooy, 2007). Between 2003 and 2006, 400,000 entrepreneurs received financial support from the *Ich-AG* scheme. Around three-quarters were still in operation some 28 months

after their launch. Given that Baumgartner et al (2006) finds that 60% of these ventures had already acquired their first customers before moving onto the *Ich AG* scheme, the strong intimation is that this measure has secured the formalisation of what otherwise would have been informal enterprises.

There is also a need for greater flexibility on the part of the tax authorities to such micro-enterprises. Many of these enterprises are relatively 'minor' enterprises in terms of the income generated so policy measures could be introduced in order to exempt them from normal tax regulations, such as by introducing standardised deductions by the sector/activities in which they work, as is the case in Australia (see Williams and Renooy, 2009).

Again, there are also lessons to be learned from other countries. In Germany, for example, the government for many years ignored the fact that many small jobs are undertaken on a self-employed basis, often by low turnover budding entrepreneurs, that are not declared (e.g. baby-sitting, gardening). To address this, a new "mini-jobs" category of employment was created. In 2002, the German government introduced three types of mini job: jobs with a €400 earning threshold; mini-jobs in the household sector; and "midi jobs" for earnings ranging between €400 and €800 (Williams and Renooy, 2008).

By 2004, the number registered as in minor employment was 7 million people. However, some 1.21 million were already in a formal job, and 580,000 were estimated to have transferred their small-scale informal entrepreneurial endeavour to the formal realm under this scheme (Baumann and Wienges, 2003). This might be one way forward for the UK government.

### *Wholly 'off the books' enterprises who intend to formalise*

The policy measures required to deal with wholly informal entrepreneurs who already possess a desire to formalise are similar to the permanent wholly informal entrepreneurs 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, this would formalise much informal entrepreneurship. For these, moreover, 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.

**Box 3: Case Study: A Formalisation Service in Italy**

In Italy, the Centres for Economic Regeneration (Centri Operativi per la Riqualificazione Economica, CUORE) was established in 1999, by the municipality of Naples and the University Federico II in order to research the local business environment. This research revealed that the principal local labour market problem in Naples was not unemployment but the 'hidden economy'. Today, CUORE consists of a network of service centres for 'hidden' entrepreneurs in low income neighbourhoods, providing information and advice to support their formalisation (Baculo, 2001, 2002, 2005).

Following a request for help by an undeclared worker, CUORE advisors, familiar with local conditions, create customised regularisation and development paths for them. Advisors closely monitor each step in the process to ensure that the enterprise follows the regularisation process and that the plan continues to suit the needs of the enterprise. By 2005 1,280 hidden enterprises had received advisory services and 326 problems have been solved (Baculo, 2005).

In addition to CUORE centres providing advice and support to informal entrepreneurs, attempts have also been made to incentivise local businesses to do the same. As a result, business consortia have been established to provide training, arrange trade fairs, help protect the originality of members' labels and products, and offer assistance with the internationalisation of their markets. The existence of this wider supportive network creates further incentives for companies or individuals to legitimise their business, allowing them to compete on grounds other than labour costs and reducing the necessity for hidden practices (*Comitato per l'emersione del lavoro no regolare*, 2003). Since its success in Naples, this initiative has started to be replicated elsewhere in Italy.

*Legitimate enterprises working partially off-the-books in a serial and on-going manner*

To tackle registered business conducting a portion of their trade off-the-books but with no intention to formalise, furthermore, 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. The use of positive role models might well help in this regard. This, however, also needs to be coupled with punitive measures for those not making the transition after such incentives are offered.

This was the group that provided the most robust defence of their off-the-books transactions, feeling quite justified in doing so because they viewed themselves as already paying sufficient taxes. This is therefore a challenging group to target with the objective of formalising their off-the-books endeavour, not least because they are difficult to identify since they operate ostensibly legitimate businesses. One way forward, given the problems in identifying them, might be what Williams and Renooy (2009) term a 'commitment' policy approach which seeks to win the 'hearts and minds' of the population so far as paying taxes is concerned.

How, therefore, can this be pursued? A recent evaluation of the advertising campaigns run by Her Majesty's Revenue and Customs (HMRC) reveals that some 8,300 additional people had registered to pay tax who would otherwise not have done so who will pay tax of around £38 million over three years, providing a return of 19:1 on the expenditure of £2 million (National Audit Office, 2008). This compares with an overall return of 4.5: 1 on the £41

million a year spent on all its hidden economy work in 2006-07 (National Audit Office, 2008). It therefore appears that advertising campaigns are relatively effective in terms of value-for-money. Such campaigns can inform:

- ▶ informal entrepreneurs of the costs and risks
- ▶ potential customers of informal entrepreneurs of the risks and costs
- ▶ informal entrepreneurs of the benefits of being formal
- ▶ potential customers of informal entrepreneurs of the benefits of using formal entrepreneurs.

Until now, most publicity campaigns have focused upon the costs and risks for informal entrepreneurs. As Thurman et al (1984) highlight, however, and reinforced by this survey of informal entrepreneurs attitudes, this is ineffective because informal entrepreneurs neutralise their guilt, such as by regarding the adverse consequences to be the result of others, who could even possibly be big players, rather than their own actions, or by disagreeing that their activity could have adverse consequences on others. As such, information campaigns should perhaps focus upon the benefits of formal entrepreneurship, not the risks and costs of informal entrepreneurship. Indeed, the above findings regarding entrepreneurs who had formalised reinforces this assertion. Many are very positive about the experience of formalising and could be used as role models and case studies by the tax authorities when seeking to encourage registered enterprises who operate serially in an off-the-books manner to fully formalise their endeavour.

Another approach is to use appeals. The question of whether normative appeals are more effective at eliciting compliant behaviour is open to debate. Although Blumenthal et al (2001) in the US state of Minnesota reveal that normative appeals only affected some groups of taxpayers, and Chung and Trivedi (2003) find that friendly persuasion is effective, it depends on the nature of the appeal made. Hasseldine et al. (2007) examine 7,300 sole proprietors in the UK. Comparing the effect of five different letters ranging from a simple offer of assistance to a letter advising that his/her tax return had been already pre-selected for audit, they find that sanction appeals were more effective than normative appeals. Their effectiveness, however, depends not only on the nature of the appeal but also the individuals addressed, including their perceptions of the social norms, the fairness of the tax system and whether there is perceived procedural justice in the tax administration.

### *Registered enterprises already in transition to legitimacy*

Examining registered enterprise trading partially off-the-books but in transition to formality, it is less advertising the benefits of formalisation and more about tackling the current barriers they face that is required.

These are four-fold:

- ▶ purchasers who demand 'how much for cash?'
- ▶ the complexity of the compliance procedures
- ▶ the lack of advice on how to formalise
- ▶ 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 which would lead to invoices being requested when purchasing goods and services or alternatively, purchasers of formal services can be offered incentives such as service vouchers. A bespoke 'formalisation service', along with anonymous telephone/internet chat-lines to offer advice and support is also required.

#### **Box 4. Service Vouchers, Belgium**

Service vouchers are a means of paying for everyday personal services. Each voucher costs €6.70 and this pays for an hour of work from certified companies that hire unemployed people. At first, the unemployed people can be hired by the company on a part-time and temporary basis. After six months, the company has to offer them a permanent employment contract for at least half-time employment if the person was registered unemployed. An employee of a certified company can carry out the following activities: housecleaning; washing and ironing; sewing; running errands; and preparing meals. 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. The Belgian government intended to create 25,000 jobs by the end of 2005.

According to Gevers et al (2005), by the end of 2005 some 28,933 people had been employed through this service voucher scheme. These employees were employed by 792 companies, of which 41% were temporary employment agencies, one quarter were private not-for-profit enterprises and 18% were public companies. The majority (90%) of the workers were employed in part-time jobs, although most work more than half-time. The 28,933 people in jobs represent 17,360 full-time equivalent jobs, a 70% growth on the number employed in 2004. However, 49% of the employed already held a job before joining the service voucher scheme. The net effect on job creation therefore was some 9,000 jobs. By the end of 2005, two-thirds of the employees were employed on permanent contracts.

During the two and a half years the scheme has been in operation, almost 200,000 households have used the voucher scheme. Although early studies found that customers previously sourced some 44% of the work now conducted using service vouchers from the undeclared economy (de Sutter, 2000), the most recent evaluation finds that only 25% reported that it would have been conducted in the undeclared economy if there had not been vouchers. One interpretation is that this scheme in its early days acted as a tool for transferring undeclared work into the formal economy but is now becoming more a tool for moving unpaid self-provisioning into the formal economy.

Gross costs for the service voucher schemes are estimated at €303.2 million, encompassing the government subsidy for the jobs, staffing costs and costs of tax deduction. The additional jobs, however, also generate returns for the government, because they result in savings in unemployment benefits, as well as surpluses in social contributions and personal income tax. These returns are estimated at €93.1 million, which brings the net costs to €210 million in 2005. The outcome is that every full-time equivalent job created through this service voucher scheme has cost some €12,500.

This group are in transition to legitimacy and wish to continue to move in this direction but suffer from some barriers to formalisation which need to be tackled. These include the need for much better information and communication of the impact of declaring earnings on benefit payments and the enterprise.

Given the lack of tax knowledge amongst this group, and that tax morality is found to be highly correlated with the level of tax knowledge, one additional potential way forward is thus to improve tax knowledge amongst such entrepreneurs. As Erikson and Fallan (1996: 399) conclude 'a successful means of preventing tax evasion is to provide more tax knowledge to larger segments of society in order to improve tax ethics and people's conception of the fairness of the tax system'.

It is also apparent that, amongst this group, the perceived fairness and justice of the tax system and administration will also have a significant impact on compliance (Wenzel, 2002). Fairness refers to the extent to which entrepreneurs believe that they are paying their fair share compared with others (Wenzel, 2004b), justice refers to whether entrepreneurs receive the goods and services they believe that they deserve given the taxes that they pay (Richardson and Sawyer, 2001) and procedural justice to the degree to which entrepreneurs believe that the tax authority has treated them in a respectful, impartial and responsible manner (Braithwaite and Reinhart, 2000; Murphy, 2005; Wenzel, 2002). As Murphy (2005) finds, those who feel they have been treated in a procedurally fair manner by an organisation will be more likely to trust that organisation and more inclined to accept its decisions and follow its directives.

Again, this has clear implications for those seeking to facilitate the formalisation of informal enterprise. Although there is felt to be no problem registering a business, most find maintaining accounts and declaring tax returns to be more difficult. Indeed, many saw it as a 'nightmare' and 'stressful'. This suggests that greater help in the form of education and packages to fill in accounts and complete accounts would be a fruitful way forward. Policy measures that might be usefully pursued in this regard range from simplifying the process of filling in accounts and paying taxes to introducing a range of new policy measures such as standardised deductions for those operating in particular sectors (see Williams and Renooy, 2009).

### **Conclusion about policy measures**

All of these policy approaches do not fit neatly into a 'one size fits all' response, but rather require a more nuanced understanding of informal entrepreneur's motivations and intentions and then a menu of interventions that can be tailored to meet their needs. To make this happen greater coordination and cooperation of all stakeholders involved in tackling the hidden economy is needed. Though this might be considered more difficult to implement by authorities it will ultimately ensure that more entrepreneurs operate in the formal economy.

We therefore recommend that a cross-sector Hidden Economy Expert Group is established.

## Recommendation

### Establish a Hidden Economy Expert Group

There is only one recommendation in this report and that is to establish a Hidden Economy Expert Group in the UK.

### Background

At the turn of the millennium, in a bid to facilitate joined-up government, a 'Grabiner Steering Group', later renamed the 'Informal Economy Steering Group' (IESG), was established to formulate and coordinate cross-departmental actions. This has now ceased operation. Not only is there now no forum to join-up strategy and operations across central government departments but neither is there currently any mechanism to involve wider stakeholders who have an interest and/or expertise in tackling the hidden economy, such as employer representative organisations, employee representative organisations, the third sector and academics with expertise in this field.

The outcome is that there is no forum for sharing knowledge on the hidden economy, a lack of opportunity for exploring how the fragmented interests can join-up their strategy and thinking, and a lack of opportunity to understand the context sensitivity of specific actions.

### Expert Group

An Expert Group can be defined as a consultative entity comprising a range of stakeholders whose mission is to facilitate greater coordination and cooperation of all stakeholders involved in tackling the hidden economy.

The tasks of the platform shall focus on promoting and developing cooperation, developing expertise and capacity-building in order to improve the efficiency and effectiveness with which the hidden economy can be tackled.

The aims and objectives might be to:

- ▶ Develop cooperation so as to arrive at a common understanding of what needs to be done to tackle the hidden economy.
- ▶ Enhance and develop expertise and capacity in how to tackle the hidden economy.
- ▶ Raise awareness and share information on issues related to tackling the hidden economy.

Given these three main objectives, optional tasks for an Expert Group might be to:

#### 1. Promote and develop cooperation between stakeholders by:

- ▶ Developing common principles and standards with regard to definitions, approaches to tackling the hidden economy.
- ▶ Facilitating the development of strategies for tackling the hidden economy
- ▶ Ensuring that current and future legislation, decisions and regulations are 'proofed' for their impacts on the hidden economy

2. Provide a framework for expertise and capacity-building in order to improve the efficiency and effectiveness with which the hidden economy can be tackled by:

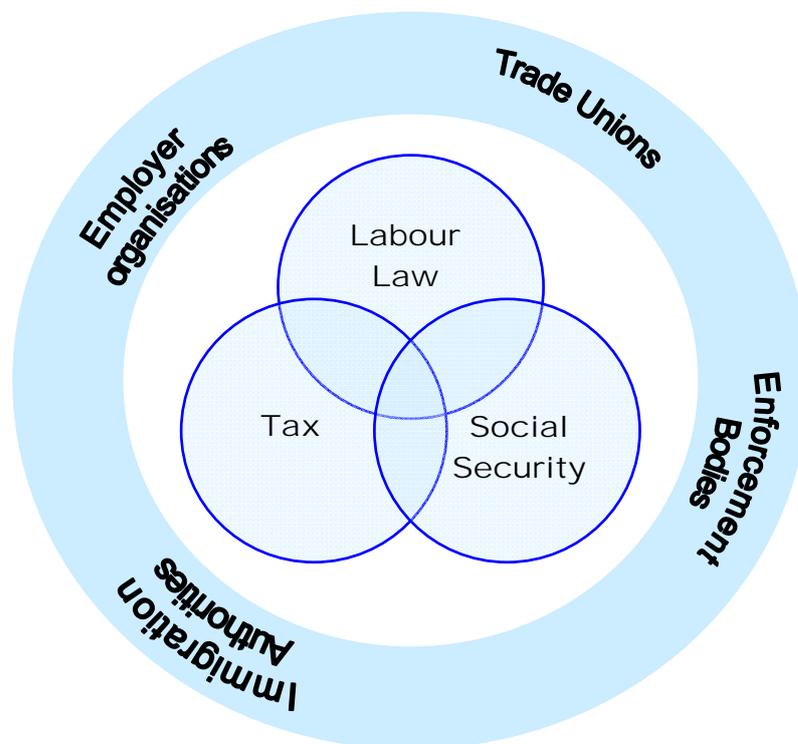
- ▶ Fulfilling a training and educational facility for all stakeholders
- ▶ Producing guides to good practice on tackling the hidden economy in specific areas (for example, construction sector, preventative measures, curative measures) and sharing innovative solutions which have proved effective elsewhere and evaluating their transferability

3. Share and exchange information and experience by:

- ▶ Exchanging best practices on all issues
- ▶ Providing a data-holding facility
- ▶ Engaging in strategic thinking about how to tackle the hidden economy
- ▶ Drawing attention to any specific or emerging issue related to the hidden economy

The Expert Group will organise workshops on various subjects related to tackling the hidden economy. These will be used to discuss new trends and issues, explore new policy approaches and develop good practices.

**Figure 3: Themes and stakeholders should be integrated in the platform**



## Conclusion

This report provides a summary of the findings from a study of informal entrepreneurship in the UK. To commence, a review of the current literature on informal entrepreneurship revealed that although informal entrepreneurship is increasingly recognised there is little understanding of the different forms it may take and of the motives of those participating in informal entrepreneurial activity.

In reviewing the different policy approaches it is clear that neither a 'laissez faire' approach nor a 'de-regulation' approach are suitable for tackling informal entrepreneurship, principally due to the negative impacts of such approaches on a variety of stakeholders and the economy generally. This leaves the 'deterrence / eradication' approach, where the focus is on punishment, and the 'facilitating / enabling' approach, where the focus is on supporting the transition from informal to formal entrepreneurship. A review of the policy and practitioner literature revealed a range of practices that fall under these two approaches which have been successfully implemented by several governments across Europe. It is apparent that whilst different European countries have adopted a variety of policy measures to tackle undeclared work, there has been little coordination or cooperation between countries in terms of sharing their experiences and learning from each other.

An important finding from the empirical data in this study is that the nature of informal activity engaged in and the motives for doing so varies greatly, variety which ultimately impacts on the efficacy of different policy responses. Consequently, rather than adopting a 'one size fits all' approach, policy responses need to be tailored to suit the demands and needs of the different types of informal entrepreneur. Whilst this report sets out some suggestions as to what policy responses may be suitable for which type of informal entrepreneur, it is recognised that there is no 'quick fix' solution and there is a need to involve a wider range of stakeholders in attempting to develop bespoke policy solutions. Thus, in recognising the heterogeneous nature of informal entrepreneurial activity and the fragmented involvement of different stakeholders in coming up with policy solutions to date, the key recommendation of this study is to establish a Hidden Economy Expert Group.

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## Appendix: Topic Guide

### **General Characteristics of interviewee**

1. Where do you live (borough)?
2. How long have you lived in this area?
3. Do you live with family members?
4. How many people live in your household?
5. Do you have dependents (children under 16 living at home)?
6. How many people in your household contribute financially?
7. How important is your business income in helping you fulfil your financial commitments?

*Here you could help the interview by suggesting:*

(1) is one of the main sources of income, (2) partial, (3) marginal/complementary

### **History of the business**

8. What is your line of business?
9. When did you start?
10. What made you start?
11. Who are your typical customers?
12. How do you get your customers? Do you advertise? Word of mouth?
13. Do you work: (a) alone; (b) with family members; (c) with friends; (d) in a business partnership?
14. If you do your business with other people, do you pay them? Do you share the profits?

### **Considerations about formalising business**

15. Are you registered with all the appropriate government authorities (Health and safety, hygiene, income taxes, VAT, etc.)?
16. What is your experience of running the business, regarding your non-formalisation? Tell us about your successes, difficulties
17. How did you overcome those difficulties?
18. Have you ever thought about registering your business with the Inland Revenue? If yes or no, why?

**If respondent says no, please go to Question 37. If respondent says yes, continue with Question 19.**

### **If the respondent says, yes: Please ask the following questions:**

19. What steps have you taken to get registered? Where are you up to now with registering?
20. If you have tried to register, how was it? Was it easy? Did you have any problems / what difficulties have you faced?
21. Are you currently registered with the Inland Revenue?

**If yes, please go to Question 29. If no, please continue with Question 22**

### **For those who have considered registering and haven't yet managed to succeed:**

22. Why have you considered registering?
23. Are you going to carry on trying to get registered with the Inland Revenue?
24. If so, what would help you complete this process?
25. If not, what has put you off?
26. What do you think about trading and not being registered?
27. Are you afraid of being 'caught' by the authorities?
28. Do you think that trading informally does not help/help your business, in terms of profits, expansion, access to credit, etc.?

***For those who have successfully registered:***

29. Why did you register with the Inland Revenue?
30. When did you register?
31. How was the registration process? How long did it take?
32. Has the registration helped your business, in terms of access to credit, more customers, being able to advertise, etc.?
33. Have there been any disadvantages to registering?
34. What do you think about trading and not being registered?
35. Are you only doing business formally? If not, why not
36. Do you think you made a good decision about registering with the Inland Revenue?

**For the respondents who said yes to question 18, this is the end of the interview.**

***If the respondent says, no in response to question 18 (I have never considered registration with the Inland Revenue), ask the following:***

37. Why have you never considered registering? Tell me more
38. What is stopping you?
39. What do you think about trading and not being registered? Are you afraid of being 'caught' by the authorities?
40. Do you think that trading informally does not help/help your business, in terms of profits, expansion, access to credit, etc.?

**Thank you very much for your time**

# Enabling Enterprise:

Tackling the Barriers to Formalisation  
Evidence, Evaluation, and Policy Implications

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Prof C.C. Williams, Dr S. Nadin,  
A.P. Barbour, Dr M. Llanes

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This report details the findings from a study of informal entrepreneurship conducted by the University of Sheffield in collaboration with Community Links.

The study sought to advance the understanding of informal entrepreneurship and suggest how informal entrepreneurial activity can best be formalised.

Based on a combination of desk and empirical research along with consultation workshops involving experts from the UK and Europe, this report provides an up to date synopsis of current knowledge relating to informal entrepreneurship.

The empirical data develops this understanding further, highlighting the varied forms of informal entrepreneurship as well as the varied motives underpinning involvement in such activity. It is against this more nuanced understanding of informal entrepreneurship that policy responses are reviewed drawing on case study examples from across Europe.

We conclude that the complex nature of informal entrepreneurship and the challenges this presents in terms of tackling it, demands greater cooperation and coordination from different stakeholders. We therefore recommend that a Hidden Economy Expert Group be established with the aim of advancing our understanding of knowledge, policy and practice in respect of informal entrepreneurship.

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