

# Majoring the Minor: Towards a Framework for Integrating Informal Industry into Formal Industry in Zimbabwe

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## Abstract

There is global consensus on the centrality of the informal sector on economic growth. More importantly, the small to medium enterprises (SMEs) have become an important engine for economic growth for developing countries Zimbabwe included. This paper looks at the formalization of the informal sector in Zimbabwe. The argument being levelled is that continued growth of the informal sector without formalization of the informal enterprises has cantankerous ramifications on the economic growth, stability and industrial development. Overgrowth of the informal sector can be oxygen for the grey- market resulting in capital operating outside the formal financial systems thereby undercutting the economy. In this study, data was obtained through a critical review of various policy papers, academic articles on the subject area. Recommendations for formalization of the informal enterprises are made. The paper sets an agenda for the gradual formalization of deserving SMES through attaching it to and anchor industry that grooms the SME into the formal industrial practice.

**Keywords:** Words: informal sector, formalisation, economic development

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## 1. Background

The birth of the concept of the informal sector in 1972 was accompanied by high optimism on its productive ability to catapult industrial development in developing countries through the utilisation of idle capital (De Soto, 1990). The failure of government policies to generate employment greatly resulted of informal SMEs in many developing countries. Mintah & Darkwah, (2018) observed a rise in the informal sector in Africa over the past decade. Mwanza and Benedict (2018) estimates the contribution of the informal sector to towards the Gross Domestic Product at over 50% in many African countries. Supporting Mwanza and Benedict (2018) position is ILO (2016) positing a 41% average contribution of the informal sector to the Sub Saharan Regional countries GDP, demonstrating the informal sectors criticality to the economic development of sub-Sahara African. Despite the varying importance of the informal sectors across the countries (Taiwo, et al, 2016), there exists a need for developing countries for anchor their industrialization agenda on the small to medium enterprises through the formalisation of the SMEs into full productive industries. The centrality of the informal sector contribution to the development of developing economies has attracted crucial policy debates towards employment creation and economic growth, however yet to generate finite solutions (Hart, 1973). However, a gape still exists on the comprehensive and pragmatic empirical and theoretical explanations that can fully explain the various issues on the full contribution and effects on the informal sector on sustainable economic development.

Since 1980, the informal sector has assumed many forms as it struggled to survive amid the laws imposed on their operations. Since independence, the informal sector in Zimbabwe has taken many shapes as the informal sector players have been forced to adjust to circumvent the restrictions, evictions, and by-laws imposed on their operations. It is estimated that the informal sector was 10% in 1980 and rose nineteen points up to 27% by 1991 (Ndiweni and Verhoeven 2013). Two significant events catalysed the growth of the informal sector in Zimbabwe. The informal sector was accelerated by the adoption of the Economic Structural Adjustment programs which resulted in massive closure of industries and retrenchments (Kawewe and Dibia, 2000). Ever since the growth of the informal sector has been unprecedented.

The second major economic event that created the informal sector was the economic meltdown that was typified by the 200-2008 hyperinflationary period with inflation rising to 79, 600, 00, 00% by November 2008. These two economic epochs stand firm in the creation of a large involuntary informal sector in Zimbabwe. Since then, the creation of the informal sector in Zimbabwe has been a mix of those who have been victims of the shrinking formal sector and those who could not find any formal job after education. To date, the informal sector in Zimbabwe has grown to compete out the formal sector. The problem being raised in this paper is the growth of the informal sector without a solid agenda for formalising the potential enterprises resulting in the informalisation of the economy. With 85 % of the SMEs informal and unregistered, (FinScope, 2012) and 86 % unbanked, transacting outside the formal banking system, this creates economic asymmetries. This scenario has led sustained grey-market activities that have negatively impacted on the formal industry. The formal industry cannot compete with the informal sector because the unregulated informal sector can afford trading at low prices while still making profits due to the absents of various tax, and compliance costs obligations. It may also explain why informal money trading outside the system is growing out of control with the Reserve Bank of Zimbabwe struggling to control

inflation due to rates determined by the informal economy. Even formal companies are reaching out to the informal enterprises to sell their products and get cash or forex to finance their formal business to the extent that the black market has become the real market. This explains why the informal sector is growing and more money is circulating outside the formal system at the time the formal business is shrinking. An urgent need for downsizing the informal sector through a systematic gradual formalisation is proffered as one of the solutions to this economic conundrum.

### **1.1 Conceptualizing informal sector, conceptual framework**

Over the last four decades, the contribution of the informal sector to development has attracted substantial attention to economic development policy especially with regards to poverty and unemployment reduction. Despite the coinage of the term “informal economy” in the 1970s, there seems to be no consensus on a universally accepted definition, (Bacchetta et al, 2009). The International Labour Organization (ILO) first defined the “informal sector” in 1972. Its characterisation was based on seven factors which include, labour-intensive and adapted technology, family ownership of enterprises, reliance on indigenous resources, ease of entry, acquisition of skills, reliance on personal resources and unregulated markets. The International Conference of Labour Statisticians (ICLS) proffered its definition with a thrust on the legal status of the enterprise. It thus refers to the informal sector as:

*“Enterprises owned by individuals or households that are not constituted as separate legal entities independently of their owners, and for which no complete accounts are available that would permit a financial separation of the production activities of the enterprise from the other activities of its owner(s)”.*  
(Hart, 1973).

The definition comprises activities that involve the provision of goods and services in exchange for remuneration, but which are not covered or are insufficiently covered by formal arrangements (ILO, 2002a). The definition captures unincorporated enterprises with unregistered paid employees that produce some unregistered goods for sale. Variability exists in terms of the number of employees in defining informal status. In Bolivia and Mexico, they use fewer than six and seven six (Prahan and Van Soest (1997), Central American economies use fewer than five, in Peru, fewer than six (Marcoullier et al. 1997), and fewer than 20 for Sudan and ten for Kenya (Livingstone (1991).

According to Ijaiya et al (2011), the informal sector covers a wide range of labour market activities either coping strategies or multiple job holding and unofficial earning strategies. To Meagher (2013) the *informal sector* simply refers to production and employment in unregistered enterprises. Williams sees it as “monetized exchange that is unregistered by or hidden from the state for tax, social security and/or labour law purposes but which is legal in all other respects” (Williams, 2011, p. 25). This absence of consensus shows the heightened attraction on the issue of the informal sector due to its centrality to development. There is no precise meaning of informal sector as it has remained a subject of controversy with many different meanings. This is because the concept informal sector has been defined to suit different contexts with different meanings (Hussmann, 2004). It can be noted that it is difficult to define conclusively the informal sector in a dichotomized manner because of the failure of size, registration, payment of taxes to discriminate sufficiently between formal and informal (Valodia and Davy, 2010). Thus the informal sector continues to be more of a continuum of situations defined by a set of parameters that are often combined to determine the position of each firm along with the informality to formality scales. (Benjamin and Mbaye, 2014, Steel and Snodgrass, 2008).

#### **1.1.1 Theoretical framework**

A plethora of theories has been propounded to account for the existence of the informal sector in developing countries. From the morass of theories, the following theories were chosen for this paper. These include the rational choice theory, the structures’ theory, The legalist theory, labour Supply theory. Table 1.1 illustrates the theories mentioned:

Table 1. The capitals, assets and revenue in listed banks

Theory	Main Proponents	Main tenants
Theory	Main proponents	Main Tenants
The Dualist Theory	The International Labour Organisation;	1. informal economy is characterized by marginalized economic activities that are dominated by the poor as a source of income and a safety net in a period of economic meltdown 2. the existence of the informal sector is attributed to the unavailability of enough formal job opportunities being created to take up surplus of labour.
Structuralist Theory	Portes et al,1989 popularized the structuralist theory in the late 1970s and early 1980s	1.informal sector should be viewed as part of the global economic system that serves to reduce input and labour costs indirectly increasing the competitiveness of large corporations 2. theory acknowledges the co-existence between the formal and informal sectors. 3. It again explains the linkages, the inter-connectedness and inter-dependency that ensure that the informal sector is a necessary component of the global economy.
The Legalist theory	Feigie (1981) and de Soto (2000) popularised the legalist theory.	legalist theory is a result of exorbitant, inefficient, cumbersome and costly government rules and regulations, which makes it hard to comply and micro-entrepreneurs tend to go informal
The Rational Choice Theory	Schneider and Enste (2000)	assumes that individuals always want to maximize their satisfaction given the available information on the benefits and costs of their action 2. there are many factors and reasons influencing individuals to formalize or to stay informal, highlighting that though economic factors should be given more weight, personal issues should not be ignored as well.
The Rationalist Legalist theory	Jamela, 2013	micro-entrepreneurs consider the social and opportunity costs involved before opting to go formal
The Recession Push Theory	Uribe-Echevarria, 1993).	The theory postulates that, in times of recession, large-scale enterprises are more affected than small and medium enterprises with many employees who would have suffered from the painful strategies of retrenchment, downsizing, rightsizing and realignment being forced to start their informal SMEs
The labour supply theory	Pedersen (1998)	SMEs' development is attributed as a response to the high levels of unemployment and it acts as a solution for the employees who cannot be absorbed in the formal economy.

These theories converge at various levels to explain the various scenarios that have led to the creation and sustenance of the informal sector in Zimbabwe. The ideal theories to the explanation of the serious development in Zimbabwe are the legalist theory, the recession push theory and the labour supply theory.

### 1.1.2 Drivers of Informal Activities

There are various drivers of informal activities. Scholars identified a plethora of reasons that explain the growth of the informal sector which include among other factors weak institutions, retrenchments, uncommitted governments, economic hardship and poverty (Onwe, 2013). Corruption and bad governance have been identified as the main drivers of informal sector participation in Nigeria. Igudia et al., (2016) identified corruption and poor governance as key drivers in Nigeria. Studies by Sookram (2008) on Small-Business Participation in the Informal Sector of an Emerging Economy' established tax evasion, easiness of entry and regulatory nature of the informal sector as key drivers in Trinidad and Tobago. These factors vary across regions and countries. They are shaped by various social, economic and political factors prevailing in the country. However, commonalities exist along with the identified factors.

### 1.1.3 Growth of the Informal Economy in Zimbabwe

The growth of the informal sector owes much to the kaleidoscopic political and economic atmosphere that

prevailed after 1990. Between 1980 and 1990, the informal sector was at 10%. The rate escalated with the adoption of ESAP and the subsequent economic deterioration that marked the economic landscape of Zimbabwe to date. Sakuhuni (2014) linked the causes of the informal economy to ESAP, economic meltdown, poverty, internal migration, famine and a desire to have an alternative means of survival and bid to enjoy tax freedom. In 2002, the ILO traced the growth of the informal economy to: out of bounce

‘...inappropriate, ineffective, misguided or badly implemented macroeconomic and social policies, often developed without tripartite consultations; the lack of conducive legal and institutional frameworks; and the lack of good governance for proper and effective implementation of policies and laws.’

Muchichwa (2017) traces the rise of the informal economy to the rise in urban population by an average of 8% per annum increase failing the urban formal economy to keep pace with the growth, the adoption of the ESAP in 1991 resulting in the liberalization of the economy, the collapse of the domestic industrial sector, and massive layoffs. The 1997-2008 economic crisis/meltdown (1997-2008) resulting in massive retrenchments and business closure most business operating well below full capacity levels, resulting in the informalisation of the economy (Muchichwa, 2017, Munangagwa, 2009).

It can be noted that both ESAP and the economic collapse led to the laying off of skilled personnel into the informal sector (Kanji & Jazdowska. 1993). Thus it must be noted that the type of the informal worker in the Zimbabwean economy is typified by a concentration of highly skilled personnel laid off by the formal employment sector. The Standard Newspaper (2014) reported that an estimated 300 000 students were churned out of schools, colleges and universities every year to join millions already unemployed. All these found themselves in the informal sector. The limited capacity of the shrinking formal economy to absorb surplus-labour, failure of industrial development to create adequate employment for the rising job seekers (Rupani, 2014), increased rate of urbanization due to rural-urban migration, the sustained economic collapse forced surplus labour to migrate to the informal sector.

#### **1.1.4 Informal sector as an engine for economic growth.**

Various scholars have pontificated on the informal sector as an engine for economic growth (Rasheed et al, 2019; Mpofu, 2017). The informal sector contributes 70% of the GDP in Ghana (ITC, 2016), 70 % in Zambia creating 88% of employment and 3% of the GDP in Kenya (African Economic Review, 2017). This is because of its ability to incubate industry. The informal sector provides enough testing ground for industrial development. Attia (2009) sees the informal sector as an engine for poverty reduction and development because of its ability to accelerate economic growth and reducing inequalities. The need is there to capitalize on the existence of the informal sector by taking both regulatory and policy steps towards creating an enabling environment for the formalization. This is because formalization brings more benefits that enhance the sustainability of the enterprise. This will help to set the deserving informal industries on a path of formal industrialization. Continued existence and growth of the informal sector without integrating deserving enterprises into the mainstream industry has cantankerous ramifications on the economy. The overgrowing of the informal sector has the negative ability to pull off capital from circulating through formal channels and circulating through the grey market which affects economic development. It is for this reason why a continued integration and formalization of the informal sectors be prioritised.

#### **1.1.5 Towards a framework for integration**

The informal sector is a transitory phenomenon that should be absorbed into the mainstream formal industrial sector. According to the Fin Scope MSME Survey (2012), 5.7 million people working in the sector, 2.8 million of whom were business owners and 2.9 million were employees. The study established that 85% of the MSMEs were neither registered nor licensed, and only 15 % were registered, vided and licensed (FinScope, 2012).

This scenario presents the Zimbabwean economy with various opportunities for industrial development. Historically, the informal sector was thought to be comprised of small enterprises, street vendors, shoe repairs and all types of relatively small and hard to tax groups. However, current trends show that professionals like engineers, lawyers, teachers and economists are operating in the hidden economy of Zimbabwe. Given that most of the workers in the informal sector are those skilled workers who were victims of industrial collapse and trained graduates who could not find employment, a window of opportunity exists for formalizing their enterprises and integrating them into the mainstream formal industry. There is need for reorganizing the informal sector, categorize it and create sustainable opportunities for formalization and professionalization.

#### **1.1.6 Steps towards integration**

First, there is a need for the government of Zimbabwe through the responsible ministries to create a comprehensive database of the functioning and closed industries. A needs analysis of the functioning industries will provide information on their products profile and product development processes. This will help to identify the stage and level upgrade informal sectors industries may be fit in a gradual process.

Second, there is a need for creating a database of the informal industry capturing the nature of the industry, skills levels, product line and their target market and skills levels. This stage is very important in categorizing and classifying the enterprise.

The third phase involves the matching of the selected informal industry and formal industries (anchor industries) that are in the same line of production. In this process, the informal industry is made to fit in the production line of the formal industry. The condition for timely and quality products are set by the formal industry. This forms the part of the regularization process. Guidance and grooming are provided by the anchor formal industry. For example, a furniture manufacturing industry may groom a group of informal SMEs and task it to produce the base mainframes for sleeping beds or lounge sofas only. The formal anchor firm would finish up the upholstery and direct the finished product to its market. In this, the informal industry invited will be gradually configured into the formal industry.

This entails that the anchor Industry (formal industry) will provide the market for the attached informal industry. This will help the informal industry to have access to markets and capital as well as setting the terms on a path of formalization. This will also help to redirect capital from the grey market rerouting it into the formal systems thereby adding value into the mainstream economy. In Zimbabwe, the FinScope (2012) established that 85% of the MSMEs were neither registered nor licensed, giving an estimated US\$7.4 billion potentially circulating outside the formal banking system. Only 14% of the SMEs owners are banked and 50% of informal business owners (1.4 million) use the informal mechanisms to manage their business finances. Hence, the government can diffuse the problematic black market through the formalisation of the SMEs which are currently the major players in circulating capital outside the formal market, because of little or no link with the formal banking system.

### **1.1.7 Conditions for formalization and future policy direction for SMEs formalization in Zimbabwe.**

Formalization is the process of legitimizing the informal sector production into the formal sector. This has many advantages for both the economy and the enterprise. The formalizing informal sector brings in capital into the formal system. This will increase the capacity of the Ministry for landing capital to the SMEs as loads for productive purposes resulting in the gradual recapitalization of the incubated SMEs and their path to formalisation. In brief, formalisation can take different forms including registering and taxing informal sector, providing business incentives and support services to SMEs, securing legal and social protection for the informal workforce and enabling the SMEs to participate in policymaking and collective bargaining processes. The following framework is therefore tendered for the formalisation process:

#### *(a) Formal registration as a full company*

Various conditions should be met by incubated enterprises. First, the selected entropized need to go through a registration process. This is an important step towards formalization. Registration brings in and confirms the legal status of the enterprise. It is only when registered that the enterprise becomes eligible for matching with an anchor industry.

#### *(b) Formal company structure*

Corporate governance requires that the enterprise create formal corporate structures that facilitate the discharge of good governance in the enterprise. According to Sun (2016), corporate governance is the way institution policies itself thru instating its customs, policies and laws to its employees from the highest to the lowest levels. Prem (2014) and Maharaj (2011) point out the need for corporate governance irrespective of the size of the institution. To SMEs, this entails the creation of relevant structures and departments within the leadership. With the guidance of the anchor industry and the ministry, the configuration of structures that enhance good governance can be achieved gradually as the enterprise achieves full integration into the formal industry. Statutes that promote transparency, accountability, record keeping and management as well as the holding of management meetings must be created (Radebe, 2017).

#### *(c) Tax compliance*

Once registered the entries should be tax complete. This is done to orient enterprise towards good governance and fulfilling regulatory requirements. It is also important as justification for receiving state loans and financial assistance as afforded other formal companies. More so such compliance creates confidence for financial institutions.

#### *(d) Compliance with labour laws*

Compliance with labour laws and working conditions for workers is also important in the formalization process. Studies by Uzhenyu and Marisa (2017) established a lack of basic lack of knowledge of industrial and labour laws among SMEs in Zimbabwe. Fulfilment of this condition is gradually expected as the incubated entries grow ad gradually formalizes. The joining relevant industrial regulatory boards are expected as deemed right by the anchor industry. This helps the particular enterprise to operate within the guidelines of the industry and thus enhances the acceptance of its products into the market.

#### *(e) Financial inclusion*

The informal sector is a key driver of capital. Enforcing compliance in financial inclusion is paramount to reduce



financial haemorrhage into the informal system. In Zimbabwe over 7.4 billion circulated outside the formal system through the informal sector, (FinScope, 2012). Compliance with financial inclusion presents a platform for good corporate governance and full contribution into the national economic system. Studies by Rasheed et al (2019) in SMEs in India showed that the SMEs that embraced financial inclusion through digitization performed better than those using traditional means. However, studies show a high reluctance of financial institution to provide services SMEs. Therefore, mitigating this negative perception on the bankability of SMEs should constitute part of increasing access of SMEs to finance. Studies by Mpofo (2017) on SMEs in Zimbabwe show that SMEs have limited access to finance low financial literacy. Shinozaki (2012) views access to finance as a not only important for the survival of the SMEs but also as a way of growing out of the SME status to a bigger formal industry.

*(f)Market research*

Most informal industries depend on an unfeasible market. Most of the market used is a grey market. This limits the maximization of the profits resulting in the enterprise failing to post sustainable profits to recapitalize and grow into a formal industry. When linked to the formal anchor industry, the anchor becomes the ready market for the enterprise. This improves the predictability of the volumes needed by the market as well as revenue inflows.

*(g)Quality control*

The anchor is charged with the responsibility for maintaining quality on the products produced by the enterprise. This together with the meeting the quality standards as set by the regulatory industrial that regulates the practice of that associated that particular will help meet the quality

*(h)Recapitalization of machinery and skills training*

While acknowledging the inherent skills already existing in the informal works because some of them were once in industries before retrenchment, there is need for updating the skills so that they are compliant with new quality and best practices required in the industry. More so, the ever-evolving technology required updating the human's skills base to improve production and efficiency resulting in the production of high quality of products that are acceptable by the anchor industry and the target market.

### 1.1.8 Conclusion

There is no doubt that the informal sector remains an engine for economic growth. Its potential to generate employment and incubate enterprises which can later develop into full formal industries cannot be underestimated. However, the uncontrolled and unregulated informal sector can become a risk to both the formal and the whole national economic development due to its potential to harbour grey-market activities that undercut the gains of economic development. This paper highlighted the importance of the informal sector as well as a framework for formalisation as a panacea to the problem.

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