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Could informal enterprises stimulate township economies? A study of two Midrand townships

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Informal enterprises are perceived to lack the necessary business and economic fundamentals to stimulate their local economies. However, informal enterprises are not homogenous. In a study of non-retail informal enterprises, we distinguish between Traditional Informal Enterprises (TIEs) and Modernising Informal Enterprises (MIEs) and assess whether Ivory Park and Kaalfontein townships have MIEs to catalyse the local economies. We find that 40% of the non-retail enterprises have a modernising orientation, but that the majority are predominantly traditional.

Introduction

Townships are economically and politically significant in South Africa and yet they continue to lurk on the margins of neighbouring urban core economies, unable to attract formal private investment. Much of the observed township business activities display the characteristics of so-called 'Traditional Informal Enterprises' (TIEs), as described by Ranis & Stewart (1999). These enterprises are seen as static, unproductive and incapable of facilitating the capital accumulation which is needed to ignite local economic development (Lewis 1954; La Porta & Schleifer 2014). Stimulating township economies requires the presence or emergence of the more dynamic and productive 'Modernising Informal Enterprises' (MIEs), with better growth and employment attributes.

The conditions for existence or emergence of MIEs are not always favourable. Structural constraints imposed by the urban spatial and economic arrangements thwart informal enterprises in any attempt to become growth drivers. In response, government has recently acknowledged that support for township informal enterprises is a key way in which township spatial and economic marginalisation can be addressed and local growth be ignited.

This article investigates the presence, or possible emergence, of MIEs that could provide the basis for stimulating township economies in South Africa. The study was done in Ivory Park and Kaalfontein townships, adjacent to Tembisa in Midrand. The World Bank (2014), in studying Diepsloot, only postulated the usefulness of the Ranis & Stewart model and did not apply it.

In our research (see Rakabe 2016) we empirically applied the framework, with important refinements, to distinguish between TIEs and MIEs, using in a firm-level survey of non-retail enterprises that were not registered for tax (i.e. informal). Our analysis also extended the model by subdividing the TIEs and MIEs into two sub-segments. This enables a more accurate classification of informal enterprises among four segments.

The significance of modernising informal enterprises: the Ranis & Stewart approach

Many in the for-or-against debate on the informal sector seem to assume that the informal sector is largely undifferentiated, both in terms of the nature of informal enterprises and how they relate with the rest of the economy. Moving away from this presupposition, Ranis & Stewart (1999) recognise that an informal-sector enterprise can be a tiny 'own-account' vegetable street trader or a micro-manufacturing shop employing up to 10 workers.

In distinguishing between the TIEs and MIEs, they identify a total of 13 characteristics (or dimensions) that seek to capture the growth and developmental elements of enterprises. MIEs embody a higher proportion of developmental attributes than TIEs. For example, they are typically seen to be large in size (with up to 10 family and non-family workers), operate from non-residential premises, use dynamic technology and skilled labour, be likely to have better linkages with the formal sector, have higher labour productivity and entrepreneurial incomes, and tend to pay more competitive wages (see Ranis & Stewart 1999: 263).

In comparison to their TIE counterparts, which produce low quality consumer goods, MIEs may produce both consumer and producer goods, destined for the local low- and middle-income markets. Further, MIEs are more likely to be involved in manufacturing, construction, transport sector and services, while the TIEs are concentrated in trade, personal services and artisanal production.

In the view of Ranis & Stewart, the MIEs offer reasonable prospects for income to grow over time, thus contributing to overall growth of the township economy – unlike the TIEs, which they see in the role of a low-income sponge that absorbs workers who cannot establish MIEs or find jobs in the formal sector (1999: 263).

Distinguishing MIEs from TIEs in the South African context

This research is based on a firm-level survey of 54 non-retail enterprises that were not registered for tax in the two Midrand townships of Ivory Park and Kaalfontein. Retail enterprises have been excluded to focus on sectors where one would expect to find modernising enterprises. The two study sites were selected because they are close to key transport corridors and industrial parks that potentially offer opportunities for employment and market linkages.

To distinguish between TIEs and MIEs in Ivory Park and Kaalfontein, we identified a total of ten variables. We incorporated some of the characteristics of the enterprises and owners that could have an effect on employment and play a useful role in determining the growth trajectory of an enterprise. These are:

- the owner's level of education;
- the owner's prior work experience;
- the owner's motive for starting the business;
- the number of workers (fewer than 3 or up to 10 workers);
- the workers' relationship to the owner (family or not);
- the type of the product sold (consumer or producer goods);
- the type of customer (consumers or enterprises);
- the employees' earnings relative to the lowest statutory minimum wage;
- the sector or the nature of the business activity (elementary or more advanced); and
- the type of the business premises (household-based or business premises).

For each criterion we identified a threshold to distinguish whether or not an enterprise exhibits a TIE- or MIE-level attribute. Then we use a *combination* of the 10 characteristics to classify individual enterprises according to whether TIE or MIE characteristics *dominate*.

To further account for heterogeneity, we separate both TIEs and MIEs into lower and upper sub-categories, again based on an enterprise's observed mix of traditional and modernising characteristics (see table 1). Thus our model comprises four segments of informal enterprises, i.e. upper and lower TIEs as well as upper and lower MIEs, instead of the two proposed by Ranis & Stewart.

Table 1. Categorising informal enterprises

| Category: | Mix of characteristics | |
|------------------|------------------------|-----------------|
| | Traditional (T) | Modernising (M) |
| Lower TIS | over 75% | 0 – 25% |
| Upper TIS | 51 – 75% | 0 – 49% |
| Lower MIS | 0 – 49% | 51 – 75% |
| Upper MIS | 0 – 25% | Over 75% |

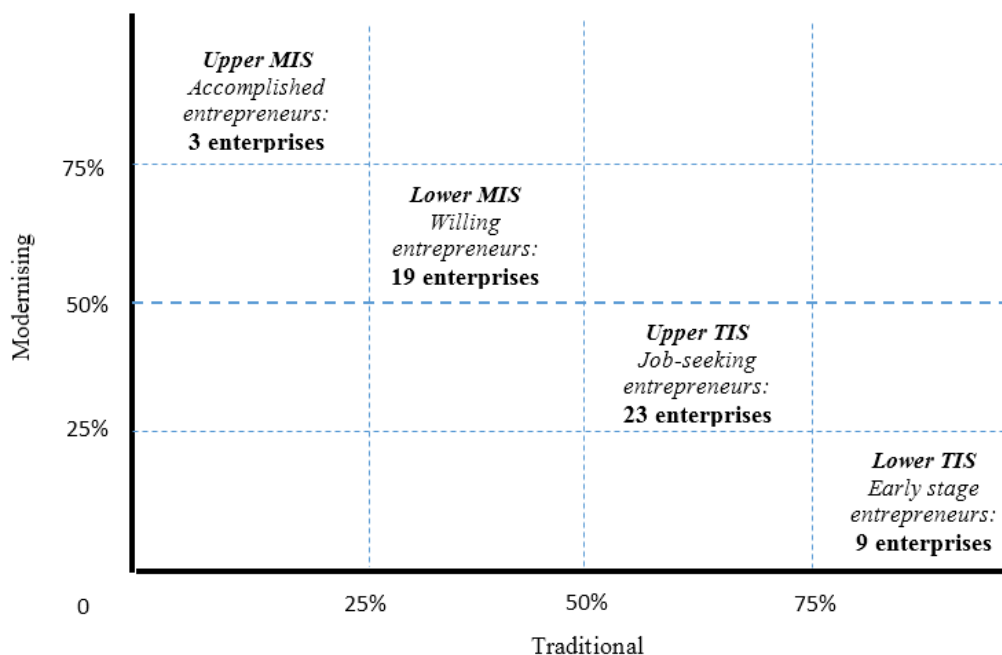
This framing enables us to place informal enterprises on a continuum of development or modernity (also see figure 1 below). The results indicate the extent to which modernising informal enterprises already exist or are emerging.

Whilst this is our focus, there is no presumption in our framework that being either a TIE or an MIE is superior or that it has a higher socio-economic value – *or* that all enterprises necessarily want to, or should, transform into MIEs.

Are there modernising informal enterprises in Ivory Park and Kaalfontein?

Figure 1 shows the classification results for our sample of 54 non-retail enterprises in terms of a modernising informal subsector (MIS) and a traditional informal subsector (TIS).

Figure 1. Classification of observed informal enterprises into subsectors



Our results indicate that most of the non-retail informal enterprises in Ivory Park and Kaalfontein are traditional in nature, with some nuances:

- 43% of the enterprises – the largest proportion – fall into the upper TIE category, which broadly represents a step away, in the degree of modernity, from the lower TIEs; the latter groups contains 17% of the surveyed enterprises;
- 35% of the surveyed non-retail informal enterprises are categorised as lower modernising enterprises (MIEs); while
- only 6% meet the criteria for upper MIEs.

In terms of a Ranis & Stewart-type interpretation, one can say that the upper MIEs appear to be run by accomplished entrepreneurs who may only be distinguishable from formal enterprises by not being registered for tax. Emerging (or lower) MIEs can be said to comprise ‘willing entrepreneurs’ whose growth prospects are probably hindered by structural constraints. The lower TIEs appear to comprise early-stage and unskilled entrepreneurs who are unable to secure formal jobs, whereas upper TIEs are made up of ‘job-seeking entrepreneurs’ who are more likely to accept a job elsewhere depending on availability.

That the majority of enterprises in the survey are traditional in nature is striking, given that the survey already was skewed towards non-trade sectors which, intuitively, are expected to exhibit more MIE characteristics. Moreover, the fact that TIEs dominate – even with such a bias in the sample – could reflect the entrenched structural-economic and spatial constraints which continue to reinforce township *underdevelopment*.

Firm and employment characteristics

Notwithstanding the modest existence or emergence of MIEs, we find that the surveyed Traditional Informal Enterprises and Modernising Informal Enterprises differ markedly with regard to various economic, employment and demographic characteristics:

- The TIEs exhibit similarities in terms of employment composition: most of them have less than three workers (owner included). The lower MIEs employ three or more workers (owner included), but – counter-intuitively – the few upper MIEs in this sample mainly comprise the owner-operator plus one employee only.
- In terms of sectoral focus, the TIEs are distributed evenly across services and manufacturing, while the lower MIEs and upper MIEs show a degree of specialisation in service and manufacturing respectively.

- Regarding education levels, both enterprise owners and workers overwhelmingly have completed secondary school, with the lower and upper MIEs indicating a relatively high incidence of vocational training.
- Ownership patterns show a strong and overall dominance of males and the youth in all four sub-categories. (Females are highly represented in clothing and textile activities.)
- We find strong family relationships between the owners of enterprises and workers in the TIE and lower MIE categories.
- Non-South Africans dominate in the upper TIEs and lower MIEs.
- With regards to business premises, residential stands and houses clearly dominate as main sites of operation across the TIEs and lower MIEs (although this may be distorted by zoning problems within the townships).
- When it comes to workers' earnings, we find that wages in TIEs are far below the lowest statutory minimum wages (those of a rural domestic worker, set at R1 800 in 2015). The MIEs appear to pay significantly higher wages than the two categories of TIEs.

Business linkages and constraints

Formal and local business linkages are crucial for the development and growth of informal enterprises. Our survey examined market linkages among the sampled informal enterprises using variables such as supplier linkages, product mix and differentiation. Linkages with formal-sector firms were also explored.

We find that local business linkages are scant, because most inputs and supplies are unobtainable in local markets. In addition, the product mix of the surveyed enterprises is not geared to respond to the value-chain needs of the surrounding formal firms that produce mass consumer goods. To be fair, developing formal-business linkages requires a different level of business sophistication – which is absent in most informal enterprises and even small formal sector businesses (Philip 2010: 17; Von Broembsen 2016).

The survey explored factors which appear to hinder the emergence or existence of MIEs in the two townships. These factors mostly are structural and relate to the perceived lack of support from government, water connections, business space and finance. Similar constraints were observed by the Work Bank (2014) in Diepsloot township. Significantly, owners of informal enterprises mostly view factors that are largely external to their

businesses as the key constraints, rather than their own limited skills or the businesses' capabilities.

Conclusion

The agenda for stimulating township economies and supporting informal enterprises needs to be cognisant of the existing local business environment and, most importantly, the heterogeneity of informal enterprises. As this article shows, informal enterprises differ in how they relate to the economy or contribute to it.

The non-retail component of both Ivory Park and Kaalfontein is dominated by traditional informal enterprises, but there is a noteworthy presence and emergence of modernising informal enterprises. The MIE component, whilst still modest, can provide the basis from which to catalyse growth and employment in the local economy *if* support measures are tailored to the needs of informal enterprises. Interventions for driving the modernisation agenda should involve stimulating the enterprise owner's personal urgency to develop, the relaxation of structural constraints by government and innovative win-win business linkages among informal enterprises as well as between informal and formal enterprises.

Policy support should also be given to informal enterprises that may not necessarily want to modernise in the sense employed here. They play an important role in development and poverty-alleviation by providing livelihoods to many poor households.

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