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# **Facilitating the formalisation of entrepreneurs in the informal economy: towards a variegated policy approach**

Research paper

## **Abstract**

### **Purpose**

Although it has been recognised that many entrepreneurs operate in the informal economy, little is so far known about their reasons for doing so. The aim of this paper is to begin to unravel entrepreneurs' rationales for trading in the informal economy in order to consider what policy measures need to be adopted to facilitate their formalisation.

### **Design/methodology/approach**

To do this, the results of an empirical survey are reported conducted in Ukraine during 2006/7 with 331 individuals who had started-up or owned/managed an enterprise.

### **Findings**

Revealing that the rationales for entrepreneurs operating in the informal economy markedly differ according to whether they are wholly or partially informal entrepreneurs operating temporarily or permanently in the informal economy, the result is a call for a move beyond a 'one-size-fits-all' policy approach and towards a variegated public policy approach whereby policy measures are tailored to tackling the different types of informal entrepreneurship, each of which operate informally for varying reasons.

### **Research limitations/implications**

No evidence yet exists of whether the rationales for engaging in each type of informal entrepreneurship, and the consequent policy measures that need to be used to formalise each type, are more widely valid. Further research to evaluate this is required.

### **Originality/value**

This is the first paper to start to move beyond a 'one size fits all' policy approach when considering how to facilitate the formalisation of entrepreneurs in the informal economy.

**Keywords:** informal sector; entrepreneurship; shadow economy; underground economy; hidden economy; tax evasion; tax compliance; Ukraine; public policy

## **Introduction**

It is now widely recognized that the informal sector is large and growing across the globe (Charmes, 2009; ILO, 2002a,b; Jütting and Laiglesia, 2009; Schneider, 2008) and that many entrepreneurs trade wholly or partially in the informal economy (Williams, 2006). So far, however, there has been little attempt to evaluate entrepreneurs' rationales for operating informally in order to consider what policy measures need to be adopted to facilitate their formalisation. The aim of this paper is to start to fill that gap.

To this end, the first section will briefly review the existing literature on informal entrepreneurship and show that few if any studies have evaluated entrepreneurs' rationales for operating informally. The second section will then report the methodology used to identify these rationales in the post-socialist society of Ukraine and the third section will report the findings. Revealing how entrepreneurs' rationales for trading in the informal economy vary across different segments of this hidden enterprise culture, the fourth section then evaluates how if informal entrepreneurship is to be formalised, a 'one-size-fits all' approach needs to be replaced by a variegated approach across the different segments of this hidden enterprise culture. The final section will then draw out conclusions and make a call for further research and evaluation of the wider validity of the policy interventions required.

Before beginning, however, a clear definition of informal entrepreneurship is required. If we define an entrepreneur as someone actively involved in starting a business or is the owner/manager of a business (Harding et al., 2005; Reynolds et al., 2002), and the informal economy as involving monetary transactions not declared to the state for tax and/or benefit purposes when they should be declared but which are legal in all other respects (e.g., European Commission, 2007;

Williams, 2006), informal entrepreneurship can be defined here as encompassing those who are starting a business or own/manage a business who participate in monetary transactions not declared to the state for tax and/or benefit purposes when they should be declared but which are legal in all other respects (Williams and Nadin, 2012).

### **Literature review: entrepreneurship in the informal economy**

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 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. However, few studies have so far evaluated whether this is the case. As Williams (2006) and Jones and Spicer (2006) explain, this might be largely because entrepreneurship as a discipline remains dominated by a wholesome, positive and virtuous ideal-type representation of the entrepreneur as a super-hero (Burns, 2001; Cannon, 1991; Williams, 2009). The outcome is that forms of entrepreneurship tarnishing this ideal-type have tended to be positioned either outside the boundaries of entrepreneurship, ignored, portrayed as temporary, or asserted to have little to do with ‘proper’ entrepreneurship.

Over the past decade or so, nevertheless, this ideal-type depiction of the entrepreneur as an object of desire has begun to be challenged. A small emergent

set of entrepreneurship literature has sought to advance an earlier body of work on how entrepreneurs do not always play by the rulebook (Kets de Vries, 1977). On the one hand, a literature on criminal entrepreneurship has begun to document the illegitimate acts conducted by entrepreneurs (Armstrong, 2005; Deutschmann, 2001; Gottschalk and Smith, 2011; Jones and Spicer, 2005; Rehn and Taalas, 2004; Sköld and Rehn, 2007; Smith, 2007; Storr and Butkevich, 2007) as well as how those pursuing illegitimate practices, such as criminal organizations, drug dealers, prostitutes and pimps, often display entrepreneurial traits (Bouchard and Dion, 2009; Frith and McElwee, 2008; Friman, 2001; Gottschalk, 2010; Smith and Christou, 2009).

On the other hand, and beyond these entrepreneurs trading illegitimate goods and services, a further literature has started to explore entrepreneurship in the informal economy where the only illicit aspect is that the remuneration is not declared to the public authorities when it should be declared (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, 2010, 2011; Williams and Nadin, 2010, 2011a,b, 2012). 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; Williams and Gurtoo, 2011). Until now, however, few studies have estimated the proportion of entrepreneurs operating informally. One of the only studies to do so finds that 77% of entrepreneurs interviewed in English localities operate informally (Williams, 2010).

On the rare occasions that informal entrepreneurs have been disaggregated into different varieties, meanwhile, 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). In other words, four broad varieties of informal entrepreneur have been differentiated:

- ‘permanent wholly informal entrepreneurs’ operating unregistered enterprises wholly in the informal economy with no intention of formalising in the foreseeable future;
- ‘temporarily wholly informal entrepreneurs’ again operating unregistered enterprises wholly informally but with an intention to formalise;
- ‘permanent partially informal entrepreneurs’ operating registered businesses and paying tax but not declaring a proportion of their income and with no intention of increasing the share they declare, and
- ‘temporary partially informal entrepreneurs’ operating registered businesses that do not declare a proportion of their income but who are in transition to formalisation.

Examining these segments of the hidden enterprise culture in English localities, Williams (2010) reveals that just 20% operate 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, with the remainder being permanent informal entrepreneurs.

Turning to the issue of why entrepreneurs operate in the informal economy, until now, this has not been empirically evaluated. Instead, the only issue investigated has been their reasons for engaging in entrepreneurship. Akin to the literature on formal entrepreneurs’ motives, the necessity/opportunity

dichotomy has taken centre stage (Aidis et al., 2006; Harding et al., 2006; Maritz, 2004; Minniti et al., 2006; Perunović, 2005; Reynolds et al., 2002; Smallbone and Welter, 2004). The distinction has been between informal entrepreneurs motivated by economic needs and opportunity-driven informal entrepreneurs.

Based on this necessity/opportunity dualism, four distinct waves of thought on informal entrepreneurs' motives for engaging in entrepreneurship has been identified (Williams and Nadin, 2010, 2011a,b). A first wave of studies assumed that all informal entrepreneurs were necessity-driven (Boyle, 1994; Gallin, 2001; Sassen, 1997) and informal entrepreneurship was portrayed as 'involuntary', 'forced', 'reluctant' or 'survivalist' (Boyle, 1994; Hughes, 2006; Singh and De Noble, 2003; Valenzuela, 2001). A second wave then argued the inverse; that they voluntarily choose entrepreneurship (Gerxhani, 2004; Maloney, 2004; Snyder, 2004). A third wave of thought moved beyond depicting informal entrepreneurs as universally either necessity- or opportunity-driven by examining the ratio of opportunity-to-necessity entrepreneurship (Edgcomb and Thetford, 2004; Valenzuela, 2001), akin to the literature on formal entrepreneurship (e.g., Harding et al., 2006; Maritz, 2004; Minniti et al. 2006; Perunović, 2005). Recently, however, a fourth wave of thought, again mirroring studies of formal entrepreneurs' motives (Aidis et al., 2006; Smallbone and Welter, 2004), has begun to highlight how necessity and opportunity can be co-present in informal entrepreneurs' motives and also how the balance accorded to each changes over time for individual entrepreneurs (Snyder, 2004; Williams, 2009, 2010).

This literature, nevertheless, only addresses informal entrepreneurs' rationales for engaging in entrepreneurship, not their reasons for trading in the informal economy. Until now, this has not been evaluated. Below, therefore, this

gap is filled in order to understand how public policy might intervene to tackle informal entrepreneurship.

### **Methodology: examining informal entrepreneurship in Ukraine**

In Ukraine, akin to other post-Soviet societies, the transition to a market society has not been easy. Official employment declined by about one-third between 1990 and 1999 (Chernyshev, 2006), some 73% of Ukrainians receive insufficient income from their main jobs to buy what they need (Rose, 2005), and 80% receive an income lower than the minimum subsistence level (Moisala, 2004). In most global league tables, moreover, Ukraine is near the bottom in terms of its corruption levels, transparency in public life and tax morality (Anderson and Gray, 2006; Hanson, 2006; Knott and Miller, 2006; Transparency International, 2006). It would be surprising, in consequence, if entrepreneurship in the informal sector was not rife in Ukraine.

In late 2006 and early 2007, therefore, an empirical study was conducted of informal entrepreneurship in this post-socialist society. Given that previous studies identify significant disparities in informal entrepreneurship between affluent and deprived as well as urban and rural populations (Williams, 2010), maximum variation sampling was used to select four contrasting localities: Pechersk, an affluent district in the capital of Kiev, heavily populated by government officials and the new business class; Vynogardar, a deprived district in Kiev comprised of dilapidated Soviet-era housing with high unemployment and widespread poverty; Vasilikiv, a deprived rural area which heavily relied on a nearby refrigerator manufacturing plant for its employment until it closed nearly ten years ago and since then has suffered high unemployment, and Uzhgorod, a



town on the Ukrainian/Slovakia border, which is the fairly affluent capital of the Carpathian region. The intention in doing so was to study a full range of economic environments so that the results did not reflect the specific conditions of a particular locality type as might have been the case if just one locality was chosen.

In each locality, a household rather than business survey was conducted because firstly, a large proportion of businesses are home-based businesses and would have been missed by conducting a business premise survey, and secondly a household survey enabled this sensitive issue to be discussed in the supportive and relatively acceptable context of the 'wide range of livelihood practices being used by households to get-by in these difficult times'. This positioned informal entrepreneurship as one of a range of coping practices being used by households during this difficult transition period.

A spatially stratified sampling methodology was used to select 150 households in each locality for interview (Kitchen and Tate, 2001). If there were 3,000 households in the area, then the researcher called at every 20<sup>th</sup> household. If there was no response and/or the interviewer was refused an interview, then the 21<sup>st</sup> household was visited, then the 19<sup>th</sup>, 22<sup>nd</sup>, 18<sup>th</sup> and so on. This provided a spatially stratified sample of each area. The 'closest birthday' rule was used to identify the participant to complete the questionnaire amongst the adults present at the time of the interview.

The household survey was composed of a structured face-to-face interview schedule using a mix of closed- and open-ended questions. To identify informal entrepreneurs and why they engaged in such endeavour, firstly, background data was gathered on gross household income, the employment status of household members, their employment histories, ages and gender, and how they secured a livelihood. Secondly, and using probes to elicit examples of entrepreneurial

endeavour, 25 common everyday domestic tasks (covering home improvement, home maintenance, routine housework, repair, tutoring and caring activities) were read out and respondents asked whether they had conducted such endeavour for others during the past year and if so, for whom it had been conducted, whether they were paid or not, and if so, whether it was an ‘under-the-table’ payment, and why they engaged in this endeavour. Thirdly, open-ended questions were asked about other self-employment and/or whether they had established or owned/managed an enterprise and if so, how long ago they had commenced this venture, whether they conducted some or all of their transactions off-the-books and various open-ended questions on why they operated in the informal economy. Below, the results are reported.

### **Findings: entrepreneurs’ rationales for operating in the informal economy in Ukraine**

The 600 face-to-face interviews revealed a high-level of entrepreneurship in these four localities of Ukraine; 331 individuals had started-up or owned/managed some enterprise. Of these, just 33 (10%) reported that their ventures were wholly legitimate enterprises registered with the state, in possession of the required licenses and all transactions conducted on-the-books. The remaining 298 entrepreneurs (90%) operated wholly or partially in the informal economy. Some 25% had a license to trade and/or the person was registered as self-employed but traded partially in the informal economy and had no intention of formalising a greater proportion of their transactions. A further 14% were again operating on a partially informal basis but were on a journey to formalisation. Some 34% operated wholly unregistered with no license to trade, wholly in the informal

economy and they had no intention of formalising, whilst the remaining 17% of entrepreneurs surveyed were again wholly informal but would consider formalising. Over half (51%) of all entrepreneurs, therefore, are not even on the radar screen of the state. In consequence, fully formal entrepreneurs are just the tip of the iceberg, below which is a vast submerged enterprise culture partially or wholly hidden from the state.

Examining entrepreneurs' reasons for operating in the informal economy, a thematic analysis of the transcripts revealed that the reasons varied markedly according to whether they are operating wholly or partially in the informal economy and whether they view themselves as in transition to formality or not (see Figure 1). To see how the rationales vary, each of these segments of Ukraine's hidden enterprise culture is now considered in turn.

INSERT FIGURE 1 ABOUT HERE

#### Rationales of permanent wholly informal entrepreneurs

Examining the rationales of the 113 permanent wholly informal entrepreneurs, three separate sub-groups can be identified since each have differing rationales for operating informally, namely those who are officially classified as unemployed, economically active and employed. The registered unemployed 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. It was also because operating legitimately was seen as too costly not so much due to the tax payments but due to the bribes that would need to be paid to state officials to remain in business. All considered that formalisation was not worthwhile. Most, moreover, considered the

income streams from their enterprise to be limited and intermittent and did not consider it a 'real' business. However, all agreed that if their customer base and turnover expanded, they might feel differently about registering the business.

Those economically inactive, meanwhile, such as the retired and house persons, operating wholly informal enterprises did so because they did not view it as a proper business, lacked tax morality due to their perception of the injustice and lack of fairness involved in paying tax on their earnings because it goes into the pockets of state officials, and adopted the view that if they tried to formalise, bribes would need to be paid.

Those operating permanent wholly informal business ventures who are formal employees (e.g., plumbers, electricians, builders, IT workers, caterers) did so mainly in order to make enough money to survive because their formal wages were insufficient to buy the basics required to get-by. They tended to use tools, contacts and so forth from their formal employment to operate their informal enterprise. For example, a woman sold off-cuts of meat, which were being thrown away in the factory in which she worked, to a local butcher and in doing so, earned more than her formal wage. These, therefore, are often 'parasitic' ventures. None operating these parasitic enterprises considered it feasible to register these businesses or operate formally because it would signal their activity to their existing employer and they saw it as an illegitimate activity. Consequently, formalisation was not seen as a viable option.

#### Rationales of temporary wholly informal entrepreneurs

Of the 56 entrepreneurs (17% of the surveyed entrepreneurs) operating unregistered wholly informal enterprises but with an intention to formalise, most intended to do so once they had established a sufficient client base. Their reasons

for operating informally were largely the same as those operating wholly informally but with no intention to formalise. They feared losing their social benefits, did not view what they did as a 'real' business, had limited and/or intermittent income streams, and feared having to pay bribes to corrupt state officials if they formalised. The only difference was that they possessed a desire to partially or wholly formalise once they had developed their client base, not least so as to be able to grow their business further.

#### Rationales of permanent partially informal entrepreneurs

Analysing the 83 entrepreneurs (25%) surveyed with registered businesses operating partially in the informal economy with no intention of more fully formalising, five reasons are apparent. Firstly, they often viewed their informal trading as being positive rather than negative in terms of its impacts. As a plumber stated, 'I do under-the-table work for pensioners. I am helping out those who wouldn't have heating otherwise'. Secondly, they viewed their under-the table transactions as small-scale compared with bigger businesses and state officials, and more as keeping their own money rather than taking other people's money. As a caterer put it, 'I am not like the police who make a fortune bribing us. I just do a little under-the-table so as to keep some money to put food on the table'. Thirdly, many thought it acceptable to work informally because 'everybody else' does so. Fourthly, participants put the blame squarely on the shoulders of the government, tax authorities or law for their informality. As a building company owner claimed, 'When I pay taxes, it just goes into the pockets of state officials so why should I. It isn't paying for education or hospitals or anything like that'. Fifth and finally, most stated that doing a portion of transactions off-the-books was a

necessity to stay in business; 'it is the only way to stay in business', 'it keeps me afloat' and 'without doing so, I wouldn't have a business'.

#### Rationales of temporary partially informal entrepreneurs

Some 46 (14%) had registered businesses operating partially in the informal economy but were on, or intended to pursue, a journey towards formalisation and a further 33 (10%) were registered and fully formalised. For these formalising or formalised entrepreneurs, four main barriers to formalisation were identified. Firstly, there is pressure from customers demanding to pay cash-in-hand, secondly, being fully compliant was seen to be a lengthy and complex process, especially when one takes into account the bribes required to stay in business, thirdly, there was a lack of advice on how to make the transition to formality and fourth and finally, a strong feeling that when starting out, the perceived benefits of formalisation might not always outweigh the potential costs of remaining informal. All the formalised and formalising participants, however, believed in legitimizing because of the new markets it opened up, the positive sense of identity owning a 'proper' business brought and the fact that they were no longer fearful of being caught.

In sum, informal entrepreneurs' reasons for operating informally vary by whether they work wholly or partially in the informal economy and are on a journey to formalisation or not. What, therefore, needs to be done to tackle informal entrepreneurship?

### **Facilitating formalisation: towards a nuanced approach**

As Williams and Nadin (2012) have shown, there are four potential options for public policy with regard to tackling informal entrepreneurship, namely ‘laissez-faire’, ‘eradication’, ‘de-regulation’ or ‘facilitating formalisation’. They find that the first option of ‘doing nothing’ is unacceptable because it leaves intact the existing negative impacts on formal businesses (e.g., unfair competition), informal businesses (e.g., the inability to gain access to credit to expand), customers (e.g., no guarantee that health and safety standards have been followed) and governments (e.g., taxes owed are not collected). Secondly, eradicating informal entrepreneurship is found to be unacceptable because it results in governments repressing through their approach towards the informal economy precisely the entrepreneurship and enterprise culture that they otherwise wish to nurture, and third and finally, de-regulation is deemed unacceptable because it results in a levelling down rather than up of working conditions. The outcome is that Williams and Nadin (2012) conclude that only facilitating formalisation is a viable policy option.

Indeed, given that most governments want to legitimise informal entrepreneurship, rather than eradicate it, facilitating its formalisation has become the dominant public policy approach in recent years (Dekker et al., 2010; European Commission, 2007, Renooy et al., 2004; Small Business Council, 2004, Williams, 2006; Williams and Renooy, 2009). Until now, however, the lack of understanding of informal entrepreneurs’ rationales for operating in the informal

economy has meant that there has been little knowledge of what needs to be done to facilitate formalisation.

Given that entrepreneurs' rationales for working informally 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 'one size fits all' approach will be ineffective. Instead, a tailored or variegated approach towards facilitating formalisation is required that tackles the different rationales for operating informally of these different segments of the hidden enterprise culture. Figure 2 outlines a range of bespoke policy measures for tackling the different rationales for operating informally amongst these four types of informal entrepreneur.

INSERT FIGURE 2 ABOUT HERE

Tackling permanent wholly informal entrepreneurs

Analysing permanent wholly informal entrepreneurs in Ukraine, 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, did not consider that they received sufficient in benefits to survive and saw operating legitimately as too costly due to the bribes that would need to be paid to state officials to remain in business. To tackle such informal entrepreneurship, therefore, policy measures are recommended such as implementing an annual disregard for benefits recipients. This would instantly formalize much of this endeavour. However, it would provide no incentive to expand the business since turnover would need to remain below the annual earnings disregard.



To encourage the further growth of their business venture and help them smooth the transition to self-employment, a gradual replacement of welfare benefits by self-employed income could be used. An example is the Ich AG scheme in Germany. Unemployed people starting up as self-employed receive 50% of the average unemployment benefit level in the first year, 30% in the second year and 20% in the third and final year. The German government expected around 20,000 start-ups to be launched (Renooy, 2007). Between 2003 and 2006, however, 400,000 entrepreneurs were supported and 75% were still in operation 28 months later. Given that 60% had already acquired their first customers before entering the Ich AG scheme (Baumgartner et al., 2006), this measure secured the formalization of some 240,000 business start-ups.

Besides such measures to allow a gradual transition from benefits to self-employment, other public measures might include promoting greater commitment to tax morality through education campaigns, stamping out government corruption, employers paying fairer wages and strengthening the psychological contract between employers and employees (Nadin and Williams, 2011).

#### Tackling temporary wholly informal entrepreneurs

To deal with wholly informal entrepreneurs who already possess a desire to formalise, meanwhile, the policy measures required to facilitate formalisation 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. A “mini-jobs” category in Germany did precisely this by allowing earnings up to €800 per annum at greatly reduced tax and social contribution rates. By 2004, 7 million people had registered and 580,000 were

estimated to have formalised their small-scale off-the-books endeavour using this scheme (Baumann and Wienges, 2003).

For these informal entrepreneurs, 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 along with stamping out corruption by government officials. The development of a ‘formalization service’ is one option to deal with the former. The CUORE (Centri Operativi per la Riqualificazione Economica) initiative in Naples, Italy is an exemplar of how this might be achieved. Neighbourhood centres provide help and advice to off-the-books entrepreneurs wishing to formalize, devise customized formalization paths and then monitor each step to ensure the path still suits the enterprise. In total, 1,280 informal entrepreneurs have received counselling and 326 problems have been solved. Help is also provided with advertising, training, trade fairs arranged, copyright help provided and aid with internationalizing their markets, thus creating incentives for businesses to formalise (Bàculo, 2005).

#### Tackling permanent partially informal entrepreneurs

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. Given that tax morality is highly correlated with the level of tax knowledge (Erikson and Fallan, 1996), measures might include providing information on where taxes are spent or more broadly, publicity campaigns to win “hearts and minds” to engender a culture of commitment to tax morality so that entrepreneurs would regulate themselves rather than be regulated by external rules. In the UK, an evaluation of the advertising campaigns run by Her Majesty’s Revenue & Customs (HMRC) reveals that 8,300 additional tax

payers registered who would otherwise not have done so, contributing some £38 million over three years, providing a return of 19:1 on the expenditure of £2 million (National Audit Office, 2008). Such information campaigns are most effective when they highlight the benefits of formal work rather than the risks and costs of informal work (Torgler, 2007). In this regard, the use of ‘role models’ both at the local and national level extolling the benefits of full declaration would be useful.

However, advertising the benefits of formalizing needs to be coupled with punitive measures for those not making the transition. Telephone hotlines, increased penalties for those caught operating in the informal economy and greater publicity of those caught working in the informal economy would be useful in this regard (Williams and Renooy, 2009).

#### Tackling temporary partially informal entrepreneurs

Examining registered enterprise trading off-the-books but in transition to formality, it is less advertising the benefits of formalisation and more 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, and 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 (which is currently a very rare practice in Ukraine), or alternatively, purchasers of formal services can be offered incentives such as service vouchers. In Belgium, vouchers can be used to pay for everyday personal services. Each voucher costs €6.70 and pays for an hour of

work from certified companies that hire unemployed people. The household pays with the vouchers which cost €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 on their tax return, which means that the price for one hour of work is €4.69. By the end of 2005, 28,933 people had been employed through this service voucher scheme by 792 companies (Gevers et al., 2005). Customer surveys reveal that 44% of the transactions using service vouchers were previously conducted in the informal economy (Renooy, 2007).

A bespoke ‘formalisation service’, along with anonymous telephone/internet chat-lines to offer advice and support is also required, as already discussed above.

## **Conclusions**

The starting point of this paper was that despite a burgeoning literature on informal entrepreneurship, few if any studies have so far evaluated the reasons for entrepreneurs working in the informal economy. The result is a poor understanding of what might be done about informal entrepreneurship. This paper has started to fill that gap by reporting the results of a survey of entrepreneurs’ reasons for working informally in Ukraine and then evaluating the policy measures that could be used to facilitate their formalisation. This survey revealed that entrepreneurs’ rationales for trading in the informal economy vary according to the extent to which they operate in the informal economy and whether or not they view themselves as in transition to formalisation.

The analysis of wholly informal entrepreneurs with no intention of formalising displays that they tend to conduct intermittent small odd jobs and not

to view their venture as a real business, fear losing their social benefits, lack tax morality, perceive their endeavour as illegitimate and raise issues about the injustices and unfairness of the tax office, not least the corrupt state officials. 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 so as to formalize much of this endeavour. To provide an incentive to expand the turnover beyond this annual earnings disregard, meanwhile, and help them smooth the transition to self-employment, a gradual replacement of welfare benefits by self-employed income could be used, as exemplified by the Ich AG scheme in Germany. Other public measures might include promoting greater commitment to tax morality through education campaigns, stamping out government corruption, employers paying fairer wages and strengthening the psychological contract between employers and employees.

Turning to temporary wholly informal entrepreneurs, their reasons for operating informally were largely the same as those operating wholly informally but with no intention to formalise. They feared losing their social benefits, did not view what they did as a 'real' business, had limited and/or intermittent income streams, and feared having to pay bribes to corrupt state officials if they formalised. The main difference was that they possessed a desire to partially or wholly formalise once they had developed their client base, not least so as to be able to grow their business further. For these informal entrepreneurs, therefore, 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 along with stamping out corruption by government officials. The development of a 'formalization service', akin to the CUORE in Italy, is thus one prominent way forward for this segment of informal entrepreneurs.

Examining serial partially informal entrepreneurs with no intention of further formalising, their main reasons for operating informally are: they often viewed their informal trading as being positive rather than negative in terms of its impacts; they viewed their under-the table transactions as small-scale compared with bigger businesses and state officials, and more as keeping their own money rather than taking other people's money; many thought it acceptable to work informally because 'everybody else' does so; they put the blame squarely on the shoulders of the government, tax authorities or law for their informality; and most stated that doing a portion of transactions off-the-books was a necessity to stay in business. For these informal entrepreneurs, therefore, it is encouraging tax morality through tax education which is required, such as information campaigns on where taxes are spent. To highlight the benefits of formal work, meanwhile, the use of 'role models' both at the local and national level extolling the benefits of full declaration might be also useful. However, advertising the benefits of formalizing needs to be coupled with punitive measures for those not making the transition, such as increased penalties for those caught operating in the informal economy and greater publicity of those caught working in the informal economy.

For entrepreneurs with registered enterprises trading partially in the informal economy but formalizing, meanwhile, it is less advertising the benefits of formalisation than help with tackling current barriers: the complexity of compliance procedures; purchasers who demand "how much for cash?"; lack of advice on how to formalize; and the perception that the benefits might not outweigh the costs. To tackle these barriers, a bespoke formalization service, along with anonymous telephone/internet chat-lines to offer advice and support is required. To combat purchasers requesting off-the-books transactions, income tax relief on self-assessed tax returns could be offered when invoices are received for

specific household tasks. Alternatively, incentives, such as service vouchers, could be offered to purchasers to use formal services.

This paper has therefore made a start on advancing the academic literature beyond universal explanations of informal entrepreneurs' rationales as well as advancing policy discussions beyond a 'one size fits all' policy approach when dealing with the hidden enterprise culture. What is now required is further research to evaluate whether the reasons for informal entrepreneurship and the policy interventions required are similar or not in other European and post-socialist nations as well as other global regions. Hopefully, therefore, this paper will encourage further research to unravel the varying reasons for different kinds of informal entrepreneurship in different contexts as well as more nuanced policy debate about what needs to be done about varying segments of this hidden enterprise culture. If this paper stimulates such research and debate, then it will have achieved its objectives.

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