

# FIELDforum

MARCH 2003

ISSUE 14

## THE INFORMAL ECONOMY AND MICROENTERPRISE IN THE UNITED STATES

### Introduction

As practitioners know, microenterprises are more common in the United States than most people realize. While ACCION USA has documented at least 13.1 million microentrepreneurs with credit access barriers, and FIELD's Self Employment Learning Project (SELP) identified at least 2.3 million low-income entrepreneurs, the role of microenterprise in the U.S. economy is still not fully understood. This is in part because a great deal of microenterprise activity occurs within the informal economy, hidden from most observers. Yet it is a potent piece of how people sustain themselves in the low-wage economy.

Informal enterprises are a powerful global economic force that affect billions of people, especially in poor countries. While their presence is obvious in the mega cities of Africa or South Asia where millions of people, caught in vicious cycles of poverty and powerlessness, struggle to survive by hawking single cigarettes, cheap watches, and other goods, the informal economy is less visible in the U.S. Yet many millions of people in the United States actively take part in the informal economy: the person on the corner selling sweaters and hats in winter, T-shirts and shorts in summer; the handyman who offers a better price for a new kitchen cabinet if he receives payment in cash.

With funding from the Charles Stewart Mott Foundation, FIELD is collaborating with the Institute for Social and Economic Development (ISED) to examine the role and extent of microenterprise in the United States' informal economy. The purpose of this Forum is to define and describe the informal economy in the United States, identify the experiences of and key issues for microenterprise practitioners, and lay out the additional research FIELD and ISED plan to accomplish.

### Definition and Characteristics of the Informal Economy

Because informal work takes so many forms, defining informal work presents many challenges. Perhaps the easiest way to define it is to identify its characteristics. Below are four key characteristics of the informal economy that are widely accepted:

#### Legal but unregulated

Within the category of informal work, activities may be legal or illegal. Economic activities can be distinguished by the manner in which goods or services are produced or exchanged. For example, food, clothing, and childcare services are legal commodities but may originate in both legally regulated and unregulated production arrangements.<sup>1</sup>

1 Rajiman, R., and Tienda, M. (2000). Training function of ethnic economies: Mexican entrepreneurs in Chicago. *Sociological Perspectives*, 43(3), 439-456.

The Informal Economy Project is funded by a grant from the Charles Stewart Mott Foundation.

**Acknowledgements:**  
The author would like to acknowledge Jan Losby of ISED for leading the research associated with the Informal Economy Literature review. We are grateful for ISED's continuing collaboration on this project. Additional thanks to the microenterprise program staff interviewed for this Forum, and specifically the staff members of ACCION Florida and ACCION New York who were interviewed several times and identified clients as potential respondents for the ongoing qualitative research.

#### FIELD

*Microenterprise  
Fund for Innovation,  
Effectiveness, Learning  
and Dissemination*

#### The Aspen Institute

One Dupont Circle, NW  
Suite 700  
Washington, DC 20036  
Phone: (202) 736-1071  
Fax: (202) 467-0790  
Web site: [www.fieldus.org](http://www.fieldus.org)  
Email:  
[fieldus@aspeninstitute.org](mailto:fieldus@aspeninstitute.org)

These activities are not intrinsically unlawful but violate some non-criminal rule or law such as not filing taxes or adhering to labor laws.<sup>2</sup>

There is a distinction between informal economic activity that derives its illegality from noncompliance with tax filings and reporting, and informal economic activity that is criminal, such as that associated with illegal drug distribution, gambling, money laundering, prostitution and trafficking in stolen goods or human beings. For the purpose of this study, the *informal economy* includes those enterprises and activities that may not comply with standard business practices, taxation regulations and/or business reporting requirements but are otherwise *not* engaged in overtly criminal activity.

### Cash as most common medium of exchange

Another key aspect of the informal economy is that cash is most commonly exchanged between parties rather than a check, payroll statement or credit card. The purpose of using currency, rather than bank credit, is to avoid creating a record of the activities.<sup>3</sup> The nature of this arrangement is captured in phrases such as, “off-the-books” or “under-the-table,” which bring to mind the image of a person receiving payment by non-traceable means.

Some transactions in the informal economy are based on an exchange of services—often called bartering or swapping. For example, an auto mechanic may not charge a fee for services provided but may expect a customer who is a dry-waller to complete the construction on a room addition. The essential element of this exchange is that there is no official record of this transaction.

### Unreported income or wages

As noted above, the nature of informal exchanges are cash or bartering so there is no record of the transaction; therefore, the income is not reported for taxation. Both the individuals who work informally and the companies who

employ them follow this arrangement. Informal workers are not claiming this income on their state and federal tax forms. Employers who “hire” informal workers are not filing employee records for state and federal taxes.

### Conditions of labor

It is important to mention that the informal economy can include both those who are employed by others and those who are self employed. FIELD’s research is more interested in the second category but it is important to recognize that the informal economy includes both types of workers and in fact, some people engage in both kinds of work. A final characteristic of informal work is the conditions under which workers are employed—where labor laws are willfully disregarded, health and safety conditions ignored, and/or in locations that disregard zoning laws.<sup>4</sup> The informal sector is generally seen as being an inferior alternative to formal sector employment in terms of earnings, security, and protection from exploitation regarding labor standards. The physical structure in which employees work may also be environmentally harmful and the equipment may be out-of-code and unsafe.

### WHO ENGAGES IN INFORMAL WORK?

The informal economy includes women and men, the poor and non-poor. Immigrants are strongly represented, as are those with lower levels of education. They are also concentrated in certain industries and occupations.

### Women and men

The data on the participation of men and women in the informal economy is contradictory. One of the few national studies that addressed this issue suggests stronger participation rates by men: O’Neill, using data from the U.S. Census

- 2 Castells, M., & Portes, A. (1989). World underneath: The origins, dynamics, and effects of the informal economy In A. Portes, M. Castells, & L. Benton (Eds.), *The informal economy: Studies in advanced and less developed countries* (pp 11-37). Baltimore: Johns Hopkins Press.
- Portes, A., & Sassen-Koob, S. (1987). Making it underground: Comparative material on the informal sector in Western market economies. *American Journal of Sociology*, 93(1), 30-61.
- Sassen-Koob, S. (1989). New York City’s informal economy. In A. Portes, M. Castells, & L. Benton (Eds.), *The informal economy: Studies in Advanced and less developed countries* (pp. 60-77). Baltimore: Johns Hopkins Press.
- Stepick, A. (1989). Miami’s two informal sectors. In A. Portes, M. Castells, & L. Benton (Eds.), *The informal economy: Studies in Advanced and less developed countries* (pp. 111-131). Baltimore: Johns Hopkins Press.
- 3 McCrohan, K., Smith, J., & Adams, T. (1991). Consumer purchases in informal markets: Estimates for the 1980s, Prospects for the 1990s. *Journal of Retailing*, 67(1), 22-50.
- 4 Castells & Portes, 13.



Bureau's Current Population Survey (CPS)—in combination with other statistics on employment, unemployment, and labor force participation rates—found that 27.1 % of adult men are engaged in the informal economy compared with only 13.5 % of women.<sup>5</sup> Yet other studies suggest that women's participation may have been undercounted. This is due to the fact that scholars have previously only focused on either women's participation in the formal labor market in general or "women's unpaid" work in the home. Only recently has research extended this inquiry to consider informal work outside of the home. Hoyman found, for example, that many female dominated occupations are also those most likely to be associated with non-filing of social security taxes.<sup>6</sup> They include:

OCCUPATION	% NOT PAYING SOCIAL SECURITY
Childcare workers not in private households	84.2
Registered nurses	49.5
Child care workers in private households	48.2
Hairdressers and cosmetologists	24.6
Dressmakers and seamstresses	19.7

Source: U.S., General Accounting Office (1983) as cited in Hoyman, 1987: 68.

Although the research conducted on women's involvement in the informal economy is not conclusive, it does challenge research that states that men are more likely to engage in the informal economy and strongly suggests that women may be as engaged, if not more, than men.<sup>7</sup>

### Poor and non-poor

The connection between a person's level of income and the likelihood that this person will

engage in informal work is unclear. The most recent research shows only slightly higher participation rates in the informal economy for lower-income people. In 1995, Jensen and his colleagues found that the percentage of families engaging in any informal activity varied somewhat across income categories; lower income families were more likely to participate in the informal economy—61 % of the second to lowest income group compared with 49 % of the highest income group.<sup>8</sup>

### Immigrants

Immigrants are strongly represented, both in informal work for hire arrangements and in informal self-employment. Researchers who conduct structural analyses of the causes of informalization note that, "immigrants, insofar as they tend to form communities, may be in a favorable position to seize the opportunities represented by informalization."<sup>9</sup> But the opportunities are not necessarily created by immigrants. Their concentration in defined urban spaces makes them easily accessible resources—cheap and flexible labor supplies—for informal production and distribution of some products and services. In addition, the need for low-cost products and services within these communities, which are not available from the larger economy (due to actual unavailability, cost or location), presents further opportunities for informal work.

### The less educated

In urban settings, the highest levels of education were more likely to be found in the formal sector, whereas those with the lowest levels had the highest probabilities of working in the informal sector.<sup>10</sup> However, this association between level of education and informal participation did not hold true in rural settings. In Nelson's study of participation in the informal economy within a rural setting, a respondent's level of education had little effect on participation.<sup>11</sup>

5 O'Neill, D. (1983). *Growth of the underground economy, 1950-81: Some evidence from the Current Population Survey*. Joint Economic Committee, Congress of the United States, Washington, DC: U.S. Government Printing Office.

6 Hoyman, M. (1987). Female participation in the informal economy: A neglected issue. *The Annals of the American Academy of Political Science*, 493, 64-82.

7 Hoyman, 64-82.

8 Jensen, L., Cornwell, G., & Findeis, J. (1995). Informal work in nonmetropolitan Pennsylvania. *Rural Sociology*, 60(1), 91-107.

9 Sassen-Koob, 60-61.

10 Gallaway, J. & Bernasek, A. (2002). Gender and informal sector employment in Indonesia. *Journal of Economic Issues*, 36(2).

11 Nelson, M. (1999). Economic restructuring, gender, and informal work: A case study of a rural county. *Rural Sociology*, 64(1), 18-43.

## Concentrated in certain industries and occupations

Industries commonly utilizing informal workers include non-precision manufacturing, electronic assembly, furniture manufacturing, automotive repair, food production and processing, textiles and apparel, hospitality and tourism, and domestic services. Informal work is also common in the construction industry, especially in painting, carpentry, masonry and laboring trades. While construction is typically identified as a high wage industry, the key to good construction jobs is through registered apprenticeships and ongoing skill development. Therefore, among day laborers, who are less apt to have access to apprenticeship opportunities, a greater amount of informal labor practices are typically found.

## WHY DO PEOPLE ENGAGE IN INFORMAL WORK?

People engage in informal work for a variety of reasons. For some it is a necessity, their only resort or their best option (e.g., it is a better alternative than low-wage formal employment). Others are involved in informal work for personal fulfillment, social obligation or as a means to supplement primary income.

A study conducted by Jensen, and his colleagues in 1995, found that while low-income participants were more likely to be motivated by economic concerns, there was more similarity than difference between poor and non-poor respondents for participation in the informal economy.<sup>12</sup> (See Table 1 on page 5.)

## IS THE SIZE OF THE INFORMAL ECONOMY SIGNIFICANT?

*The underground now includes people down the block who sell a variety of goods and services—from firewood to scarves to housecleaning to haircuts to fence posts—all on the condition that payment must be made in cash and is, therefore, difficult for taxing authorities to trace. It also includes the many self-*

*employed people who hide—or fail to report—business income or who engage in barter...*

*—McKenzie & Lee, 1991<sup>13</sup>*

Because of its very nature, the informal economy poses tremendous challenges to researchers attempting to estimate its size, and while they have endeavored a variety of approaches, the measurement process remains an inexact science. Despite differences in technique, and results, what emerges clearly from the data is the understanding that the informal economy in the United States is surprisingly large. Estimates of the relative size of the underground economy in the United States vary greatly and range upward to 15 and even 25 percent of GNP.<sup>14</sup> Castells and Portes note that “about three-fourths of the U.S. establishments counted in the census were VSEs (Very Small Establishments) in 1965, and they absorbed approximately one-seventh of the economically active population (EAP). Twenty years later, the figures were almost exactly the same...”<sup>15</sup>

## THE INTERSECTION OF MICROENTERPRISE AND THE INFORMAL ECONOMY

*To paraphrase Granovetter (1985, p. 334), small may not be beautiful, but it is certainly bountiful, and the combined activities of small and unregulated operations now appear to be of more than marginal significance.*

*—Portes & Sassen-Koob, 1987*

Research has identified that microenterprises, while not the dominant way that US residents engage in the informal economy, are substantial. The very nature of being a micro—or very small—enterprise lends itself to operating in the informal economy.<sup>16</sup> These enterprises are largely invisible or operate at low levels of visibility. They may or may not have licenses, are often engaged in casual hiring, unreporting of income and other informal labor practices. They can be easily moved, opened or closed at will, and thus, can hide from regulation.<sup>17</sup>

12 Jensen, Cornwell & Findeis, 91-107.18-43.

13 McKenzie, Richard B. & Lee, Dwight R., (1991). Government in Retreat, *NCPA Policy Report* No. 97.

14 McKenzie, Richard & Lee, #97.

15 Castells & Portes, 21.

16 The definition of a microenterprise is a business with five employees or less, that requires \$35,000 or less in start-up capital.

According to the US Census, the definition of a Very Small Establishment is a firm with fewer than ten employees.

17 Castells & Portes, 11-37.

**TABLE 1:  
RELATIVE IMPORTANCE OF REASONS FOR ENGAGING  
IN INFORMAL WORK BY POVERTY STATUS**

Reasons	Percent Reporting Reason as Somewhat or Very Important		
	Total	Poor	Non-Poor
To help out neighbors	60.8	64.8	57.8
Because you have to survive	53.7	65.7	44.1
Lets you work at home	43.9	48.1	40.8
Not enough good jobs around	43.5	50.0	38.8
You can set your own hours	40.0	42.6	38.1
You can be your own boss	36.1	33.3	38.1
Because income is not taxed	32.9	33.3	32.7
No transportation worries	21.6	29.6	15.6
Regular job would cut welfare	11.8	21.3	4.8

Source: Jensen, Cornwell & Findeis, 1995: 99

People working in the informal economy respond to niche markets, especially in the urban sector, that have been left open in the transformations of the economy since the 70s. In her research, Sassen suggests that there are at least three areas in which microenterprises can and do thrive in the informal economy in the urban sector:

- responding to the needs of high-income consumers who seek high quality, non-mass produced items and personal services,
- serving low-income workers who find the costs of goods and services on the open market prohibitive, and
- serving commuters and tourists flowing into urban centers on a daily basis through low-cost service operations.<sup>18</sup>

Each market niche requires different skills and marketing strategies, and presents different opportunities and constraints to growing an enterprise.

The first, for example, can result in high-income gains if the product or service hits the mark in terms of the sensibilities and interests of a sophisticated audience. On the other hand, it can also require taking advantage of low-cost labor to produce at a price the market will bear. The second may offer a broad market, but one that is price constrained, and the third suffers from high levels of competition and low marginal returns. Being successful in any of these is a challenge.

Much of the informal entrepreneur's advantage relates to price, and therein is the greatest challenge in working with this sector: It is not necessarily obvious to microentrepreneurs that going "formal" will be economically beneficial, which suggests one reason that many microentrepreneurs do not seek out the services of non-profit programs.

However, these competitive advantages can also pose constraints to growth. Microenterprises operating on a cash basis cannot demonstrate the

18 Sassen-Koob, 60-77.

capacity to manage business loans, leaving entrepreneurs either operating with very low levels of capital, or more expensive and limited sources of financial support (informal sources, personal loans and credit cards, etc.). They cannot accurately value their businesses if they choose to sell them. Neither can they become too visible in their marketing, for fear of becoming apparent to regulators.

## MICROENTERPRISE PROGRAMS AND INFORMAL MICROENTREPRENEURS

### Outreach

One of the questions that this research is designed to answer is to what extent informal entrepreneurs are a market for microenterprise programs? In fact, some microenterprise programs already serve informal economy entrepreneurs, occasionally in substantial numbers. Of the twenty programs surveyed by FIELD staff,<sup>19</sup> seventeen serve people with informal businesses, three had not served any to date, and one program stated that they would not necessarily refuse service to informal entrepreneurs, but did not know of any informal entrepreneurs served to date: “our goal is get businesses above ground.”

In responding to this question, program staff noted that all or most businesses start informally. Very few microentrepreneurs launch their businesses with legal incorporation and the filing of a DBA. So, many of the “informals” they serve may be temporarily operating in this way. They are in the start-up phase and are interested in learning how to formalize their business. These clients may differ in substantial ways from those who’ve engaged in the informal economy for a long time.

Secondly, few programs report specific strategies for recruiting these longer-term informals. PPEP-Micro, for example, recruits clients using radio, flyers and city meetings, and has found it to be effective in recruiting both formal and informal entrepreneurs. Microbusiness USA, in Florida, also does not use specially targeted recruitment strategies, yet has found that about 70-80% of the people who come to them seeking loans are working informally. BusinessNOW of Goodwill, in Atlanta, GA, uses word of mouth as its primary

recruitment strategy and has found that informals are their primary clientele. While the organization doesn’t consider this to be a special recruitment strategy for this population, in fact, word of mouth referrals have been found repeatedly to be a powerful outreach mechanism, and it may well be that their original clients are closely linked to informal entrepreneurs, and continue to replicate themselves through this recruitment strategy.

Informal entrepreneurs are a challenging market to access. Similar to many start-up entrepreneurs, they do not always consider themselves businesspeople, but rather just think of themselves according to their trade (e.g., “I make tamales and sell them”, not “I am an entrepreneur”). ACCION USA actively responds to this way of thinking. Staff specifically includes discussions about informal enterprises as a part of orientation sessions. During these sessions they talk about home-based businesses, street vendors and store fronts, and give people concrete examples of what each of these are. Making clear that their services are accessible to a whole range of businesses is a part of their messaging and the goals of their program.

### Demographics

The “informals” who seek program services are similar to other program clients in some respects, but differ in others. They tend to be patchers. Their businesses are usually not their primary or only source of income. They may also be engaged in work that is “above the table,” or they may work “under the table” for another business owner. (The exception is childcare workers. Program staff stated that childcare workers who are working informally are commonly caring for others children while their children are young, as a way to stay home full-time with their children. These women most often do not have other jobs, either formal or informal, and these tend to be lower income clients.) Informals tend to be similar in income to other clients, although two programs believed that their informals are lower-income than others they serve. One differentiating factor for programs serving undocumented immigrants is that these clients cannot legally work in the United States and are therefore unable to register their businesses. Therefore, for programs that serve undocumented immigrants, these businesses remain informal.

<sup>19</sup> FIELD staff sent a survey to 500 microenterprise practitioners in the United States and interviewed all respondents willing to discuss their answers to the survey.



## Most common industries among informals

The range of industries in which informal entrepreneurs participate mirror those mentioned in the literature, but also extend beyond them. These entrepreneurs seem to be as diverse as those working formally. Practitioners report clients are in retail, selling clothing, crafts and jewelry, in food businesses including catering, as well as in cleaning, childcare, home improvement and lawn/tree service. FIELD's interviews with Latino informal entrepreneurs has found respondents in all these categories as well as others. Among 38 interviews, FIELD found 12 food businesses (including catering, meal preparation and specialty foods), nine child care businesses, five retail businesses, five cleaning businesses, four home improvement/repair businesses (run by skilled tradesmen) and three crafts businesses. The sample also included two auto mechanics, two seamstresses doing alterations, two odd jobs men, a car washer, a beautician, a transport service, a disc jockey, a real estate advisor, a party planner and a seller of high-end water filters. (Some respondents report multiple economic activities.)

## Why entrepreneurs don't formalize

Program staff have identified a complex of reasons why informal entrepreneurs choose to remain so, some of which are difficult to challenge. They include fear, lack of education or information, legal status and choice.

### **Fear:**

*"Often they don't see the incentives to do so [regulate their businesses]. They are afraid of paying taxes. They are not educated about the types of deductions you can make as a small business owner, and they are afraid of paying taxes. The street vendors are afraid of getting put in jail"*

*—Staff member, ACCION USA.*

There are several fears that practitioners identified. Informal entrepreneurs have an overall fear of the government, and the possible repercussions of regulating. Once they are licensed, entrepreneurs are concerned that state government representa-

tives will enter their homes to inspect their businesses. They anticipate that the amount they would have to pay in back-taxes could put them out of business. They fear being closed down because they are not up to code, or that the cost of bringing their activity up to code could put them out of business.

*Haitians and Hispanics are not used to sharing anything about their business with others. It takes extra effort to work with them and have them feel comfortable. They have been remote from the banking system and are fearful of the government becoming involved in their businesses.*

*—Staff member, MicroBusiness USA*

## Lack of education or experience

Practitioners report that informal entrepreneurs are not comfortable with basic financial services and transactions. Many do not have checking accounts, and only use cash. This is especially common in immigrant populations. Entrepreneurs are also uncomfortable with the amount of paperwork necessary to transition their businesses to the formal sector. Learning how to manage books, document revenues and expenses, and comply with tax requirements and other regulations appears daunting.

## Immigrants and documentation

Undocumented immigrants face barriers due to language, cultural differences, and immigration regulations that limit their employment options. They are subject to exploitation because of their exposure to explicit or implicit threats of being reported to immigration authorities if they object to working conditions or pay. By starting their own businesses, they are less subject to this threat working under someone else, but they remain "at risk," regardless of their enterprise. According to practitioners, for undocumented immigrants, legalizing a business may not be a matter of choice, forcing them to operate in the informal economy. Therefore, they are taking a risk in terms of violating both their immigration status and violating their status with the IRS.<sup>20</sup>

<sup>20</sup> Interviews with Latinos in NJ suggest that some undocumented individuals have found ways to incorporate their businesses. While they do it as a strategy to purchase, register and insure their vehicles, and little else, it does present the possibility that an undocumented individual might operate his/her business in a more legal or regulated way than would at first appear possible.

### *A matter of choice?*

For other entrepreneurs, program staff observe that the choice not to regulate may be calculated. They understand that it may not be financially advantageous to regulate if the business stays below a certain size. Some entrepreneurs realize that their market does not offer them the potential for growth, and they are better off remaining “under the table.” This is particularly true for those who work on a seasonal or occasional basis (as many crafters, food preparers and skilled trades people do). There also may not be the desire for growth on the part of the entrepreneur. For example, some women work in the informal childcare industry to stay at home with their children.

### **Do programs require clients to register their businesses?**

Programs do encourage enterprises to formalize. Although the majority of programs interviewed do not require entrepreneurs to formalize their businesses, almost all programs interviewed deliver a clear message that formalizing is a desired goal.<sup>21</sup> The messaging strongly encourages entrepreneurs to regulate their businesses, and includes explanations of the legal requirements as well as potential benefits of regulating.

Program staff’s own observations have led them to conclude, however, that entrepreneurs are more inclined to make the transition from informal to formal when they are interested in growth and there is a need for cash or other resources to fuel their business: “They see that with more dollars coming in, their inventory is getting better and sales are increasing. There is a possibility to make more money, and they want to make more money.”<sup>22</sup> Only by regulating are entrepreneurs able to access the larger loans needed to take their business to the next level. Formal bank sources will only lend to legal businesses, and programs themselves make legal registration a requirement for larger size loans as well (see below). Additionally, for certain contracts, particularly with government sources, a business requires a license. Or simply if the person purchasing goods or services from the entrepreneur needs to pay by check rather than cash, the entrepreneur may find him/herself in a position where s/he needs to formalize.

The pressures that programs feel to encourage regularization of enterprises are strong. Programs are publicly supported nonprofits, and they are supposed to teach what is “right.” Additionally, some program staff have funders who want to measure them by the number of regulated businesses that emerge from their training programs. For example, BusinessNOW of Goodwill Industries in Atlanta developed outcomes measurements collaboratively with one of their largest funders. The number of reported regulated businesses is a part of their funders’ reports. Therefore, the real pressure, in addition to the psychological pressure programs feel about the need to encourage program participants to regulate their businesses may constrain programs’ abilities to take the businesses as they are. Eight of the programs interviewed stated that funders require business, registration as an outcome measurement. Most of these requirements are from state and other government funding sources. Four other programs said that these outcomes are implicitly required by funders, but they do not have to report specific numbers.

However, program staff have encountered situations in which formalization is not necessarily to the clients’ advantage:

*I do not discourage people from formalizing, but I remember having that thought. A woman on TANF did cleaning on the side for years. Because of Welfare to Work, she needed to get a job. Social Services was open to her starting a business, and we got her a loan. But then the cleaning business didn't work as a job that could support her fully. I don't know if she is cleaning on the side now or not. I do not think the loan helped her financially because she couldn't really write anything off. [She didn't] have anything to write it off against.*

*—Staff Member, New Enterprises Fund, Inc.*

This type of situation provokes serious questions on the part of program staff. In the interviews, practitioners repeatedly indicated that they face real issues determining at what point programs should recommend that clients register their businesses. Are there situations when it is disadvantageous to the entrepreneur to encourage him/her to regulate his/her business? A staff member at BusinessNOW asked, “Are we directing

21 The exception to this is the programs working to train entrepreneurs in the childcare industry. These programs require childcare workers to formalize their businesses in order to complete their training program.

22 Interview with staff member, PPEP Microbusiness and Housing Development Corporation, Inc.





people appropriately to tell them to formalize their business? Are we doing more of a disservice to them by encouraging them to formalize? Is it truly beneficial to them, or is it just a benefit to the economy?” A staff member at New Enterprises Fund, Inc. wants to understand “how to respect the line between formal and informal. When is it best to stay informal as far as the person’s whole life is concerned and not be too pushy and push people into something they later regret that is not helpful? You can’t preach to them, there is a reason they are doing it the way they are doing it.”

## The challenges of providing assistance to informal entrepreneurs

The practitioners interviewed cited challenges that programs face when working with informal entrepreneurs:

- **Limiting risk**

Programs limit the amount of credit they will offer informal entrepreneurs. Organizations interviewed that are loan focused will give small loans, but for larger loans, a business must be regulated. BusinessNOW has mini-loans of \$250 that are available for unregistered businesses. Micro-Business USA allows anyone to participate in their basic training and their \$500 loan program. However, when an entrepreneur reaches the level to request a \$2500 loan, the business must be legal. ACCION USA offers smaller loans to unregistered businesses. This is mostly by virtue of the industry, not necessarily because they are unregulated. Their large loans of 15-20K are for more formalized businesses.

- **Difficult to evaluate credit worthiness**

It is a challenge for programs to evaluate the credit worthiness of a loan application without financial documentation. Staff find it hard to understand if the entrepreneur has the cash flow to service the loan. This makes underwriting more time intensive. Program staff has to sit down and talk with the client to draw out information, instead of looking at cash flow forms. They have to do site visits to verify assets and operations; they need to

pursue alternative forms of collateral to guarantee the loans.

- **Time intensive services**

Staff members stated that informal entrepreneurs require a variety of services. These include case management services focused on personal issues, as well as strong financial training or technical assistance. Staff invest time helping entrepreneurs understand budgeting and tax flow analysis, financial statements, and basics such as banking and how to balance a checkbook: “I have found that they need a lot of hand-holding in terms of the [loan] application process. They are the least organized in terms of presenting information to us. A lot of time is spent sitting down with them to get their financial information from them through a conversation versus a ledger, or formal forms.”<sup>23</sup>

Additionally, staff report that informal entrepreneurs require access to markets services to help them build customers outside their usual networks.

- **Developing trust**

Program staff face challenges building trust with informal entrepreneurs. There is fear among entrepreneurs of exposing themselves: “Part of the problem or the issue is that we are constantly working on maintaining a certain level of trust with the client mainly so that we can help them. Because they are used to trying to protect what they have, the more you reveal, the more will be taken away from you. That is something that we always have to overcome.”<sup>24</sup> Programs also need to help entrepreneurs to trust the banking system, and the legal system, all of which may be foreign to the informal entrepreneur. Additionally, there may be cultural obstacles to overcome when assisting immigrant populations.

- **Lack of legal documentation on the part of the entrepreneur**

Lack of legal documentation on the part of undocumented entrepreneurs creates extreme limitations for these entrepreneurs and challenges for programs trying to serve these

<sup>23</sup> Interview with staff member, Accion USA.

<sup>24</sup> Interview with staff member, Cobb Microenterprise Council

clients. Some programs decline to give even small loans to undocumented immigrants, requiring clients to have a valid social security number, which undocumented immigrants are unable to legally obtain. These programs are usually publicly funded, receiving state and city money where there are regulations regarding how the money can be spent. The Union County Economic Development Corporation, for example, cites the regulation of the SBA Microloan fund.

However, there are programs willing to give loans to undocumented immigrants. ACCION USA, for example, has an official policy that they will not reject anyone based on their immigration status. Most of the funds that ACCION USA receives have no strings attached in terms of who they are able to serve. ACCION has made a conscious choice to work with private funders for this reason. ACCION Texas is the only office receiving SBA money, and they are using this money for clients who are renewal loans, and therefore tend to be formal businesses and documented immigrants.

In order to work with undocumented immigrants, ACCION employs risk mitigation strategies: “We try to tell people to be frank up front. It works against a client if they give us a false social security number, and we learn that it is fake when we do the credit check. In

the case of a higher risk person, we would consider use of a false Social Security number as a mark against them. ... We create an environment where people feel comfortable, and therefore people feel comfortable telling us that they are undocumented from the beginning.”<sup>25</sup> Staff members look for signs of stability, including how long a person has been in the country, and whether s/he has a stable living environment.

In addition, they look for alternative documentation when a client does not have legal immigration status. In the case of the higher risk client, sometimes staff will ask for a guarantor, a cosigner who is documented. In order to verify the person’s home address, they will ask for bills or personal letters addressed to the individual at the address where s/he lives. According to one ACCION staff member, “We have learned as we go along. The details of how we work with undocumented clients is not formal in our policies and procedures, and a lot of it is not written in stone—they are procedures that we have acquired. With our funders, we walk a fine line. We don’t want to give too much information to our funders, yet we want to be frank with them about the clients that we serve. Therefore, we shy away from funders who have extensive restrictions.”

## ASSESSING UNDOCUMENTED LOAN APPLICANTS

- **PROFILE OF HIGHER RISK CLIENT:** single young male, entered the country six months ago, living in rental apartment. This person would not necessarily be turned away for a loan, but it would depend from situation to situation. Staff would look for qualitative information when talking to the client and make a loan assessment based on these conversations.
- **PROFILE OF LOWER RISK CLIENT:** person who has been in the country for five years. S/he is married and has kids in the country. S/he is renting an apartment, or living with family members. This person is probably not going anywhere because s/he has ties to the community—his/her kids are in school.

—ACCION USA

<sup>25</sup> Interview with staff member, Accion USA



- **Capturing data on service effectiveness**

Microenterprise programs have a strong need to capture data on the effectiveness of their services to clients, and a key way that they seek to do this is through collecting data on business sales and profitability, as well as household income. Their interests in collecting this data can clash with the interest of informal entrepreneurs in keeping it to themselves. For example, many individuals blend informal and formal work. This blending may occur not only between a formal job and an informal one, but also within an enterprise itself. Small, licensed companies may resort to unauthorized productive arrangements during times of financial crisis.<sup>26</sup> There may be a formal presence and reported income, masking informal aspects of its operation—a certain percentage of its sales made "under the table," wages paid off the books to occasional workers, cash transactions, etc. These realities suggest the real contradiction that exists between a microenterprise program's interest in reporting profitability and income gains for individuals served, and the individuals' needs to hide income for tax purposes.

- **Recruitment**

*Often they do not have a car or do not drive so they couldn't get to the other classes. One of them I met at a homeless shelter after a fire. Then I went to her own home. All of them I have done one on one—Classes are not in their way of life. Either no car, children, sometimes a 45 minute drive. I actually enjoyed it because it gave me some up-close personal experience with people. It helps me realize what people's lives are like and how tough they are and that we are expecting a lot of people wanting them to come to class and write a business plan.*

—Staff member, *New EnterprisesFund, Inc.*

As mentioned above, most programs don't have special outreach mechanisms to reach informal entrepreneurs. Part of the recruitment challenge is identifying who in the informal economy might be potential clients for services. According to ACCION USA, "often [informal entrepreneurs] are the ones that don't ask for it, but we see a need for them to have [services]. They are hard to convince to go and take classes." Programs need to recognize the diverse motivations of those who participate in the informal economy, and that some may be candidates for program services and some never will.

Among those entrepreneurs that may remain difficult to access are the following:

- Individuals with "good jobs" who pursue a second self-employment activity less for any immediate economic gain than as a risk management strategy (in case of job loss) or as a creative outlet
- Individuals with "bad jobs," who lack sufficient capital to fully invest in the development of a business, but who engage in irregular income generating activities or "odd jobs" for immediate economic gain<sup>27</sup>
- Individuals in rural areas pursuing "odd jobs" in the absence of formal sector opportunities of any type
- Individuals in these same areas engaged in nonmonetized exchange aimed at strengthening their social and economic networks against hard times<sup>28</sup>

26 Fernandez-Kelly, M. & Garcia, A. (1989). Power surrendered, power restored: The politics of work and family among Hispanic garment workers in California and Florida. In L. Tilly, P. Guerin (Eds.), *Women, politics, and change* (pp. 130-149). New York: Russell Sage Foundation.

27 Nelson, 18-43.

28 Duncan, C. (Ed.). (1992). *Persistent poverty in America*. New York: Auburn House.

Levitan, L., & Feldman, S. (1991). For love or money: Nonmonetary economic arrangements among rural households in central New York. In D. Clay and H. Schwarzwiler (Eds.), *Research in rural sociology and Development* (Vol. 5, pp. 149-172). Greenwich, CT: JAI Press.



## CONCLUSION AND NEXT STEPS

Despite some obvious disadvantages, there are strong reasons why some people remain informal. The informal economy has few barriers to access, and this is especially important to undocumented workers; economic remuneration is attainable; and the avoidance of burdensome regulation is an undeniable boon to small-scale operations. And for many microentrepreneurs, it is not clear whether the benefits of formalization outweigh the costs involved. As microenterprise practitioners have observed, the desire to grow, and a corresponding need for financing, appear the most compelling triggers. The challenges listed above are those perceived by practitioners. There are likely others as perceived by the informal microentrepreneurs themselves. For example, entrepreneur's motivations for participating in the informal economy may not allow them to see

themselves as candidates for traditional business plan training courses, or even loans. A big challenge may be identifying the types of products and services that might make better sense for these entrepreneurs, or finding ways to work on larger constraints to their more public participation in the formal economy.

Future documents under this project will report on the results of interviews with informal entrepreneurs in three major metropolitan areas and in rural communities. Going forward, FIELD will summarize the implications of this research for policy and practice. It is hoped that this work will provoke greater recognition of this substantial, yet hidden, component of the "microenterprise market," and lead to strategies that can more effectively help people move from marginality to economic self-sufficiency, using self-employment as a tool.

**For the complete literature review and future research on the Informal Economy, please go to <http://www.fieldus.org/li/InformalEconomy.htm>**

Author:  
Erika T. Malm

Content Editor:  
Elaine Edgcomb

Editor:  
Greg Landrigan

Production Manager:  
Colleen Cunningham

Designer:  
The Aspen Institute

Printer:  
Economy Printing

The Aspen Institute  
One Dupont Circle, NW • Suite 700  
Washington, DC 20036  
Phone: (202) 736-1071  
Fax: (202) 467-0790

*Microenterprise Fund for Innovation,  
Effectiveness, Learning and Dissemination*

