



A Conceptual Model for the Development of Indicators for Informal Markets

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Abstract

Informal markets are recognised as presenting lucrative business opportunities for the private sector. However, informal markets function by a different set of rules when compared to the formal sector, and so require a different paradigm altogether. The approach proposed in this report sees the convergence of conventional micro economics with development economics and the theories of sustainable development.

A community is used as the unit of analysis for the informal market. A model is proposed that uses the sustainable livelihoods framework to describe the various elements of the community as a system, and how these interact to produce desired outcomes.

This study was designed from the perspective of measuring the informal market. Measurement allows quantification and qualification of the phenomenon of the informal market and allows for more effective decision making. The conceptual model was therefore developed to gain a theoretical understanding of the phenomenon to be measured. A systems perspective is taken to develop a high-level framework for indicator selection. This is considered to be the first, in a series of steps, towards developing indicators for the informal market, and even a single composite indicator for the informal market.

A small sample of experts was interviewed to explore the informal economy from their own observation and experience. The insights shared in the interviews pointed to the applicability of the proposed model to informal markets, and demonstrated the complexity of these markets. A number of further research opportunities can be explored to further develop this concept.

Declaration

I declare that this research project is my own work. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration at the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination in any other University.

Pratibha Mistry

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To my supervisor, for opening my mind to a new frame of thinking, and providing support in taking the more exciting route.

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We all stand together.

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CHAPTER 1 RESEARCH CONTEXT

1.1 Introduction

The economic discourse in South Africa found focus around the concept of the dual economy when President Mbeki introduced the terminology of the “two economies” in 2003 (DBSA, 2005). This has promoted the view of a marginalised and dysfunctional ‘second’ economy that is dissociated from the growth and benefits of the modern and functional ‘first’ economy, which generates the bulk of the country’s wealth.

Some argue that the use of the metaphors of ‘first’ and ‘second’ economies is a simplistic representation of the complex historical basis of the present South African economy (Devey, Skinner and Valodia, 2006; Frye, 2006). They go further to state that this metaphor serves to mask the failure of government policy to address the imbalances of poverty and underdevelopment.

Schneider (2002) found that in the year 2000, the average size of the informal economy in developing countries, as a percentage of Gross National Income, was 41%. That represents a significant portion of the economy that is not officially accounted for. Further, there are significant linkages between the formal and informal economies, in terms of labour movements (Devey *et al*, 2006), household expenditure and business supply chains (Ligthelm, 2004).

In spite of these divergent views, the debate has elevated the informal sector to high level policy and business dialogues. The government’s present economic

policy, the Accelerated and Shared Growth Initiative for South Africa (ASGISA), aims to simultaneously accelerate growth of the economy and reduce poverty. It proposes to integrate interventions at a macro economic and micro economic level, by linking procurement policies, Broad Based Black Economic Empowerment (BBBEE) mechanisms, small business development and skills development with large scale capital investment.

The private sector too is recognising the opportunity presented by the so called 'bottom of the pyramid' markets. With 5.2 million South African households earning less than R20 per day (Eighth20, 2006), these represent lucrative markets for innovative products, produced on a high volume, low cost basis.

1.2 Poverty and Inequality in South Africa

Through South Africa's history, from the time the Dutch first settled in the Cape in 1652, to the beginning of the mining industry, with the discovery of diamonds in Kimberley in 1867 and gold in the Transvaal in 1886, the imperative of driving down the cost of labour by racial exploitation and oppression had been a dominant feature of the economic and social landscape (Development Bank of Southern Africa (DBSA), 2004).

With the election of the first democratic government in South Africa in 1994, social reform and economic redistribution became priorities in redressing the imbalances left by apartheid. However, poverty and inequality have increased in South Africa since 1993 (DBSA, 2005), in spite of macro-economic stability, high social expenditure and GDP growth averaging 3% between 1995 and 2004.

“Jobless growth” has been a glaring feature of the South African economy, as demonstrated in Figure 1, which compares GDP growth to employment over 26 years, from 1979 to 2004.

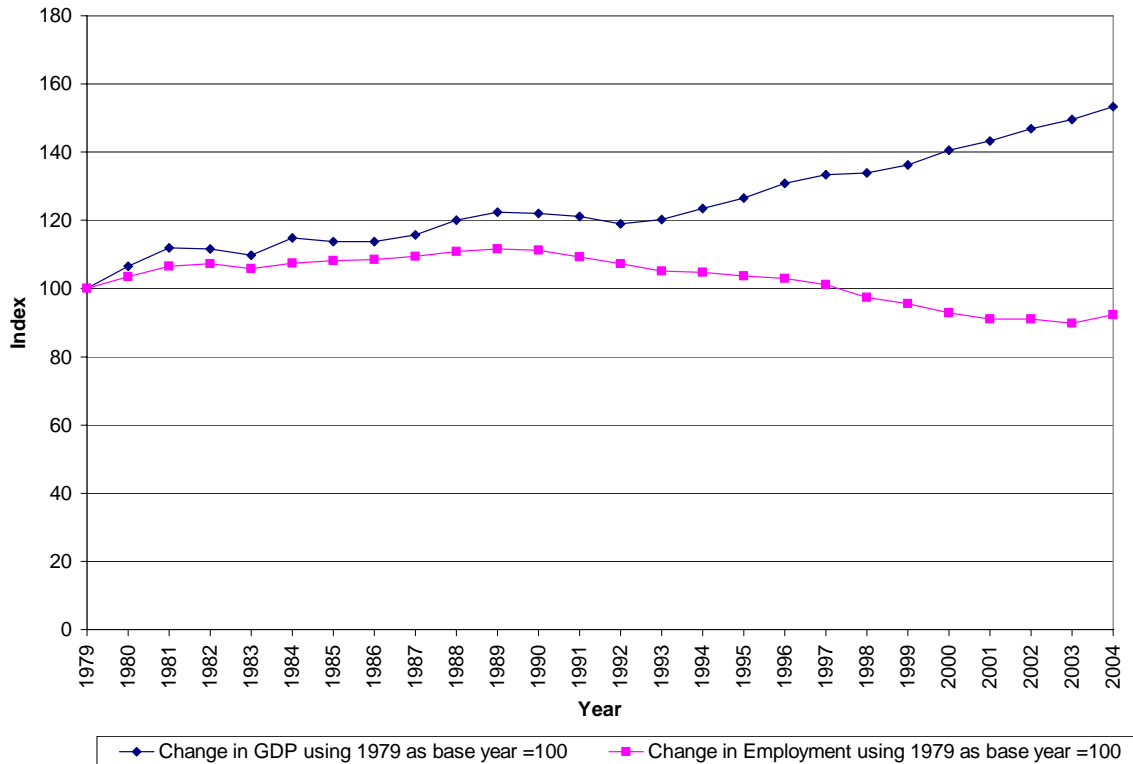


Figure 1. Change in GDP compared to change in employment, from 1979 to 2004, using 1979 as a base year (Ligthelm, 2005)

Economic growth is widely recognised as an effective means of combating poverty, by expanding the labour market. Juan Somavia, the Director General of the International Labour Organisation, said “We need to give far more weight to the creation of productive jobs if we are ever to attain the objective of halving the numbers of those who live in extreme poverty by 2015” (Somavia, 2005). However, an expanding economy is contrasted by the rise in inequality (Landman, Bhorat, Van der Berg and van Aardt, 2003). When the base of initial

inequality is high, as is the case of South Africa, the poverty reduction benefits are reduced (DBSA, 2005). In South Africa, poor households are disconnected from the labour market, with lower labour participation rates and higher unemployment, compared to higher income strata (DBSA, 2005).

The informal economy is often viewed as a “safety net” to alleviate poverty, by providing a refuge of productive employment opportunities when faced with exclusion from the formal economy. The informal economy in South Africa is relatively small, at 18% of total employment, compared to Brazil (51%) and India (56%) (DBSA, 2005). This could be partly attributed to the long history of oppression, suppressing the spirit of entrepreneurship that is a necessary component of the success of the informal economy, as a means alleviating poverty and underdevelopment.

This entrepreneurial inertia can be attributed to underinvestment in the education of black people by the apartheid state; an unfriendly environment for small business, including a limiting regulatory and tax environment, and a lack of effective demand for their goods and services; and the impact of HIV/AIDS on “poorer households’ ability to cope, let alone accumulate and thrive” (DBSA, 2005, p32).

In summary, the point of the challenges faced by the poor in South Africa, is succinctly made by the following paragraph by DBSA (2005, p51): “ So the poor remain poor, because they cannot borrow against future earnings to invest in inputs for production or the accumulation of assets for future production,

including education. In the absence of opportunities for engaging in paid employment, they are unable or unwilling to enter into entrepreneurial activities because the costs of failure are too high, they are unable to insure themselves against risks, and they lack information about market opportunities. Finally, although significant improvements have been made in the provision of services, the poor remain deprived of many public goods necessary for entrepreneurial activities (such as property rights, public safety and infrastructure), and incur high costs in time and expense when trying to obtain these goods.”

1.3 The Role of the Private Sector

As much as the current policy debates around the “first” and “second” economies have resulted in an intellectual separation of these as distinct and disparate economic structures, there are significant linkages and interactions between the formal and informal sectors of the economy. The formal sector has a significant interest in the ‘marginalised’ communities, who represent a large and lucrative market for their goods and services. It is within the interests of the formal business sector to see increased purchasing power within this market. The private sector would also benefit from a reduction of the business costs associated with the social problems of high crime rates, poor health and the lack of skills.

Traditionally, formal businesses held the perception that the poor do not constitute a viable market. In his seminal book ‘The Fortune at the Bottom of the Pyramid’, Prahalad (2005) demonstrated the latent potential of the poor as

a profitable market. He characterises the bottom of the pyramid as being a global market of four billion people that earn less than \$4 per day.

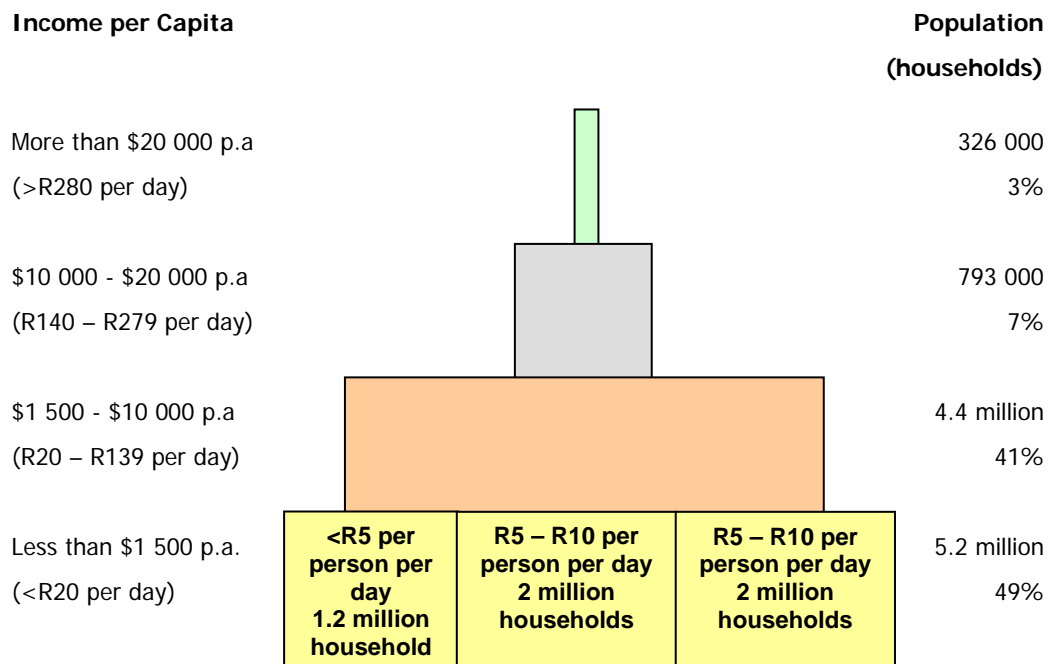


Figure 2. The South African economic pyramid (Eighty20,2006)

Figure 2 shows the economic pyramid for South Africa. The bottom of the pyramid, termed the 'aspiring poor' by Prahalad and Hart (2002), constitutes 49% of households in South Africa that earn less than R20 per day (Eighty20, 2006).

People within the bottom tier of the economic pyramid do not hold legal title to their assets, have little or no formal education, and are usually difficult to reach by conventional distribution, credit and communications (Prahalad and Hart, 2002). The quality and range of products and services available to this tier is

low, and this presents immense market opportunities that were previously invisible to the formal business world.

Prahalad and Hart (2002) challenged multi – national corporations to defy their “conventional managerial logic” and radically change not only their existing business models to create innovative products that “combine low cost, good quality, sustainability and profitability”, but also to radically innovate on how they go to market. Increasing the earning potential of the poor is therefore a private sector imperative in developing these markets.

1.4 Motivation for Research

The measurement of economic activity in the informal sector is becoming increasingly important, not just as a means to inform future public policy, but also to provide business with a means to characterise and compare market performance.

Often, because a lack of understanding of the informal economy, businesses are reluctant to engage in bottom of the pyramid markets. A conceptual model will provide a theoretical and practical basis around which the informal market can be understood and measured. This will allow businesses to design products and product strategies within a contextual framework that is relevant for the informal market.

Further, there is an increasing need among government institutions, development finance institutions, non-governmental organisations and aid

organisations, to prove the effectiveness of their development interventions. The real impacts of these interventions are most commonly at the localised project level, having microeconomic impacts that usually occur in the informal sector. Although there have been many indicators that have been developed to measure various aspects of development impact, there is no single aggregated index that describes the overall level of economic activity.

Numerous techniques have been proposed to measure the size of the informal economy, from various macroeconomic discrepancy methods and currency ratio methods, census and survey methods, to physical input methods that look at electricity consumption patterns (Schneider, 2000; Feige, 1990). Although census and survey methods have dealt with the problem on a microeconomic level, there is a gap in understanding the real drivers of the informal economy from a microeconomic perspective.

1.5 Research Aims

The aims of the research are to:

1. Gain a conceptual understanding of the workings of the informal market, and to develop a conceptual model to describe this understanding.
2. Provide a framework around which indicators can be developed.
3. Explore how experts working in the informal economy understand the informal market, from the perspective of developing indicators for measurement.

Although the development of a composite indicator of economic activity lies outside the scope of this project, this research is viewed as a first step in achieving this end, and was conducted with that final aim in mind.

1.6 Outline of the Research Report

This report is divided into seven chapters, beginning with a review of the current literature on the informal market and economic measurement in Chapter 2. Chapter 3 outlines the research questions that emerged from the review of the literature, followed by a description of the research methodology employed to answer these questions, in Chapter 4. The theory base for the development of the conceptual model for the informal market is presented in Chapter 5. Chapter 6 proves the applicability of the theory base to the informal market by application of the data obtained in the expert interviews. It goes further to propose a high – level framework for developing indicators to measure the informal market. The report is closed in Chapter 7 by recommending further avenues of research to understand the elements of the informal market, towards developing a comprehensive set of indicators for its measurement.

CHAPTER 2 LITERATURE REVIEW

2.1 Introduction

This chapter reviews the current literature on the informal sector and how it is defined. It tries to paint the current picture of the informal market, as it is viewed in the South African context. This chapter also examines how economic measurement is approached for the informal economy, and what are the steps required for the development of a composite indicator.

2.2 The Informal Market

2.2.1 Definition of the Informal Economy

The informal economy as we view it now was historically the dominant paradigm of doing business, before rapid industrialisation in the late nineteenth and twentieth centuries resulted in the need to enforce controls on business transactions. The informal economy exists everywhere in the world, varying by size, but often displaying similar characteristics.

In their analysis of the informal economy in Latin America, Portes and Schauffler (1992) presented three theoretical perspectives of the origins of the informal economy: the dual economy approach, the unregulated economic activity approach, and the unregulated labour market approach.

The dual economy approach echoed similar sentiments to the South African government's current policy, where the economy was viewed as being segmented. The informal economy was a result of exclusion from the modern

economy, especially with respect to excess labour supply in the formal economy (Portes and Schauffler, 1992). This implied a countercyclical relationship between the two economies, in that as the formal economy grows and absorbs more labour, the informal economy would decline, and vice versa.

In spite of concomitant growth in both formal and informal employment during times of economic growth in Latin America after World War 2, this conceptualisation of labour spill over continued to lead to the view that the formal and informal economies were countercyclical

In the late 1980s, Hernando De Soto gained popularity with his view that the informal economy came about as a popular response to excessive regulation by the state, which is referred to as the unregulated economic activity approach by Portes and Schauffler (1992). In this view, the informal economy was not viewed as under-productive and inefficient, but rather as the “irruption of real market forces in an economy straight jacketed by mercantilist regulation” (Portes and Schauffler, 1992, p4).

The third perspective, the unregulated labour market approach, takes the view that, although the informal economy is closely linked to excess labour supply in the formal economy, it came about as a result of state regulation. It viewed the informal sector as an integral part of the modern economy, with unregulated activities being defined as “activities that circumvent the costs and are excluded from the benefits and rights incorporated in the laws and administrative rules

covering property relationships, commercial licensing, labour contracts, torts, financial credit and social security systems” (Portes and Schauffler, 1992, p5).

In 1993, the 15th International Conference on Labour Statistics (ICLS) proposed an accepted international definition of the informal sector for statistical purposes. At this conference, an enterprise based definition of the informal sector was proposed. The informal sector enterprises, which were seen as “any unit engaged in the production of goods and services for sale or barter”, were defined using the following criteria (Hussmans, 2004):

- The private unincorporated enterprises cannot be legally separated from their owners and there is no financial separation between the production activities of the enterprise and other activities of the owner;
- The number of people employed is below a certain threshold level, which is dependent on national circumstances. The United Nations Statistics Division's Delhi Group on Informal Sector Statistics suggested a threshold of five employees.
- The enterprise is not registered under specific legislation and/ or their employees are not registered.
- They are engaged in non-agricultural activities.

This enterprise based definition was criticised for the tendency of people surveyed, who are engaged in small scale self - employment, to not report their

activity. It was unable to capture the increasing trend of ‘informalisation’ of employment, for example sub-contracting and freelancing, where employment is atypical and irregular (Hussmans, 2004).

The 17th ICLS, held in 2003, incorporated a more job-based view to the above definition, using the conceptual framework illustrated in Table 1. This new definition shifts focus from unregulated enterprises to employment relationships that are not regulated (Chen, 2003).

The type of production unit, showed as rows in the matrix, is related to the enterprise type and is classified into three groups: Formal sector enterprises, informal sector enterprises, as discussed above, and households, which produce goods for their own use and which employ paid domestic workers (Hussmans, 2004). The columns represent job categories represented by the status of the individual in employment, and as either formal or informal employment.

Table 1. Conceptual framework used in 17th ICLS definition of informal employment (Hussmans, 2004)

Production Units by type	Jobs by status in employment								
	Own-account workers		Employers		Contributing family workers	Employees		Members of producers' cooperatives	
	Informal	Formal	Informal	Formal	Informal	Informal	Formal	Informal	Formal
Formal sector enterprises					1	2			
Informal sector enterprises	3		4		5	6	7	8	
Households	9					10			

The grey blocks represent jobs that do not exist within that production unit and the yellow blocks represent formal jobs. The numbered blocks represent the informal sector as informal employment (Cells 1-6, 8-10), employment in the informal sector (Cells 3-8) and informal employment outside the informal sector (Cells 1-2, 9-10).

This provides a more multi-dimensional view of informal activities, which do not exist solely among informal enterprises and cut across the boundaries of the so called first and second economies. This definition also tends to be a more labour based view, which may skew the dialogue on the informal economic activities, at the cost of other factors, like the availability of capital, the occurrence of natural resources and the spirit of entrepreneurship.

In South Africa, the Bureau of Market Research developed the taxonomy of the economy (Figure 3) that is coherent with the South African government's view of the first and second economies running in parallel with each other (Ligthelm, 2005). However, like the 17th ICLS definition, it recognises that informal activities may occur in the formal sector as an unrecorded component, which includes unregistered, non compliant or underreported businesses. The second economy includes household activities, and a third economy is added, which are illegal activities.

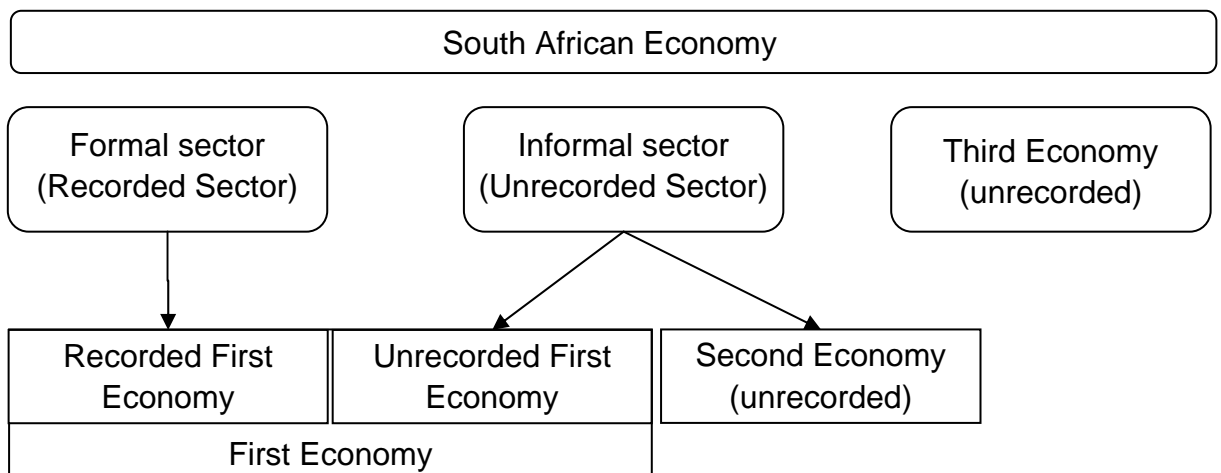


Figure 3. Structure of the South African economy by type of activity (adapted from Ligthelm (2005))

Ligthelm (2005, p. 4-5) describes the informal economy as embracing “unreported income from the production of goods and services - legal and illegal from monetary or barter transactions – hence all economic activities that would have been taxable if reported to tax authorities.” Within this taxonomy of the South African economy, the informal sector is defined as the combination of the unrecorded part of the first economy and the second economy.

The above confirms that economic activities form a continuum from strictly formal to completely informal, and that the informal economy is in itself a complex and pervasive phenomenon that cannot be separated from the formal economy.

This study considers just one aspect of the informal sector, which is the ‘second’ economy, as defined by Ligthelm (2005) above. This study focuses on the localised, microeconomic impacts of projects and products, and therefore

takes the more traditional, enterprise based view of the informal sector. This will be termed the 'informal market', since it describes the exchange of goods and services in a highly localised context, but does not view these activities as isolated from the formal economy. On a practical level, the picture of the informal market, as perceived in this study, is a generalised, typical township scene, with hawkers, spaza shops, general dealers and a myriad of service providers, interacting directly with members of local households.

2.2.2 Size and Trends in the Informal Market in South Africa

Ligthelm (2005) estimated the size of the informal sector (defined as the combination of the second economy and the informal part of the first economy, as shown in Figure 3) in South Africa using survey methods. The study estimated that, in 2004, the informal sector contributed 4.6% of GDP, and employed 2.1 million people.

In 2004, a total of R51.7 billion was spent in informal businesses in South Africa, which represented 6.3% of total household cash expenditure for the country (Ligthelm, 2005). The second economy component, which is the focus of this study, employed approximately 1 720 900 people and was estimated at making a 2.1% contribution to GDP at basic prices (Ligthelm, 2005).

The labour absorption rate, which is the percentage of population of working age (15-64 years) that is employed in the formal economy, is in decline, as shown in Figure 4. The decline in employment in the formal economy has seen

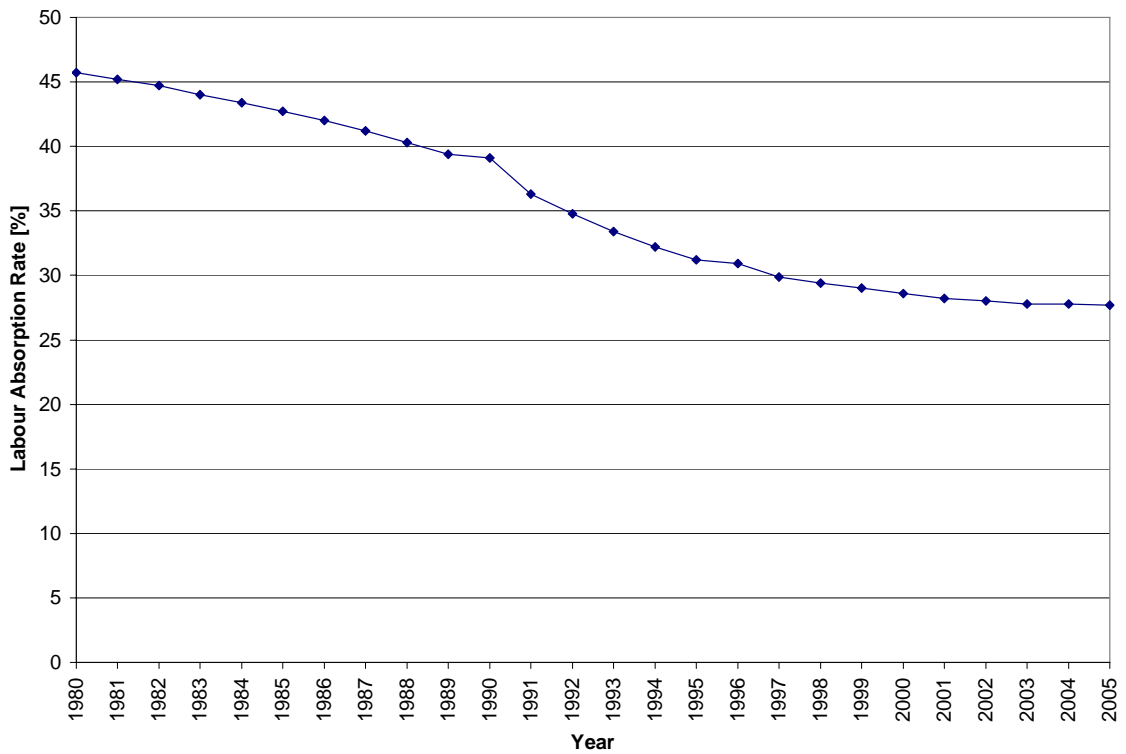


Figure 4. Labour absorption rate of the formal economy from 1980 – 2005 (Ligthelm, 2005)

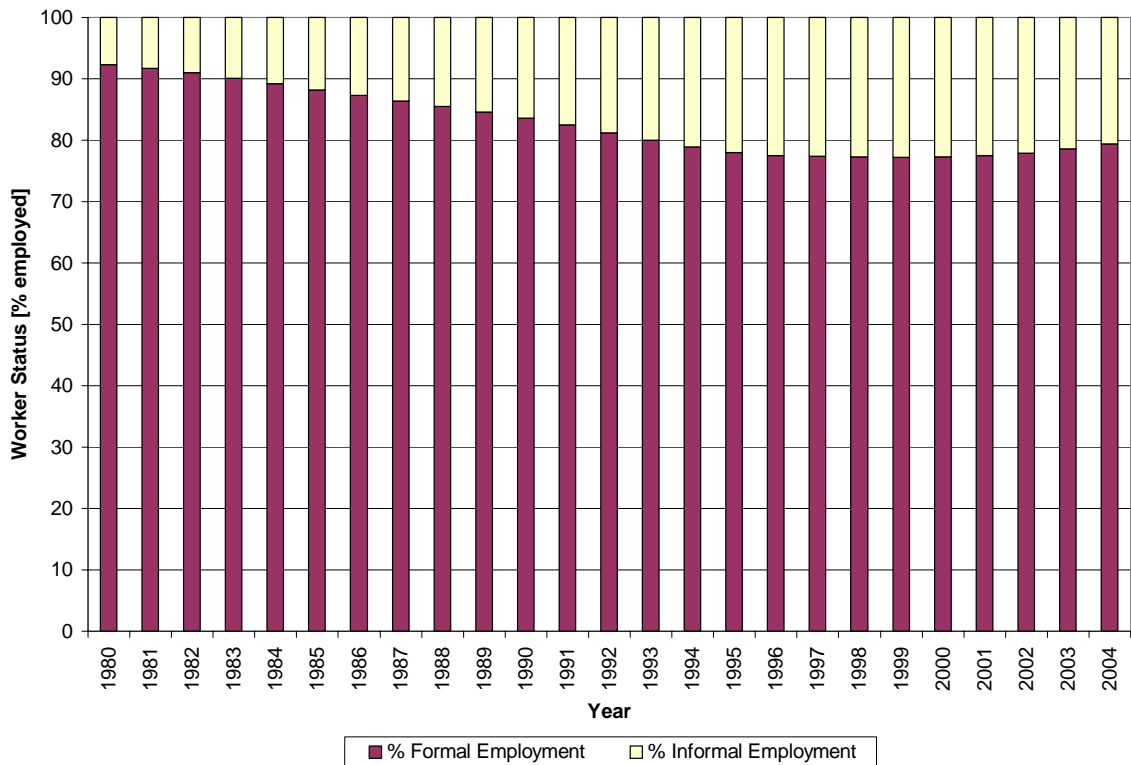


Figure 5. Employment status of workers, 1980 – 2004 (Ligthelm, 2005)

an increase in informal employment with time, as shown in Figure 5. In recent years, the increase in economic growth has seen an increase in formal employment, but the informal sector still employs over 20% of the total workforce.

2.2.3 Profile of the Informal Market in South Africa

The informal market at a localised level is characterised by the interactions between local households and the businesses that serve them. The income distribution of informal enterprises is shown in Figure 6. The figure shows the correlation between working in the informal economy and being poor, with 51% of workers in informal enterprises earning less than R500 per month, and 92% earning less than R2500 per month (Devey et al, 2006).

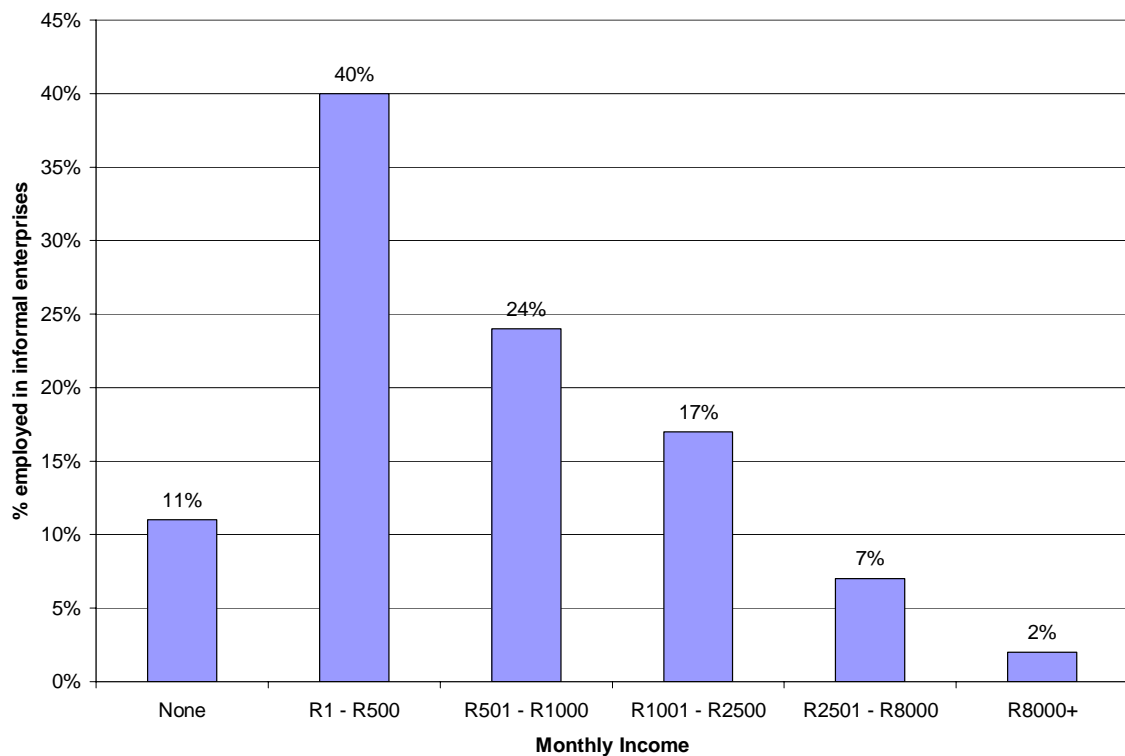


Figure 6. Incomes in informal enterprises, March 2004 (Devey et al,

2006)

In terms of type of employment, employment in informal enterprises is dominated by trade, followed by employment in construction, manufacturing and services sectors, as shown in Figure 7 (Devey et al, 2006).

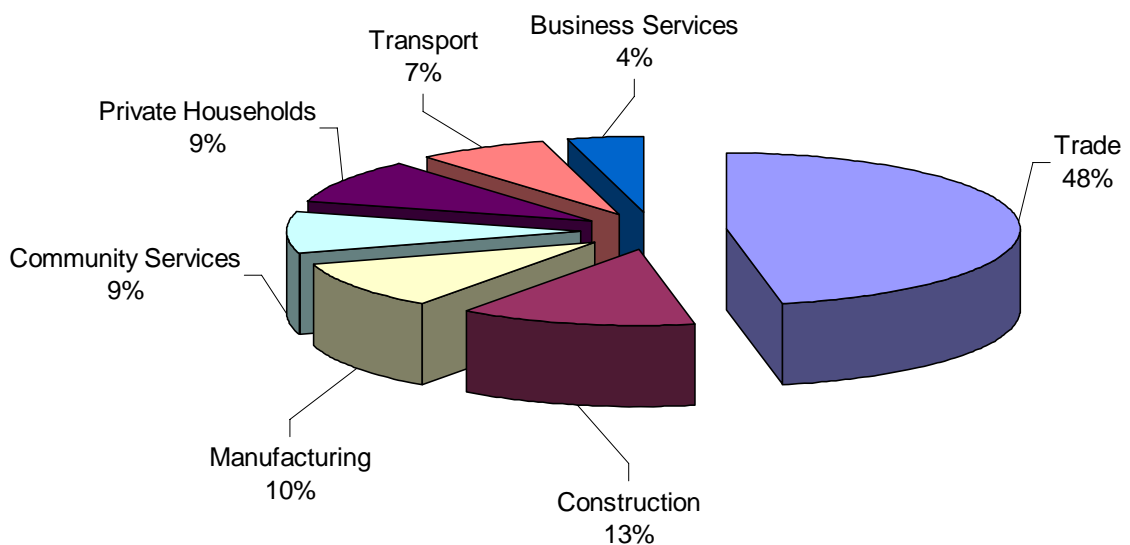


Figure 7. Workers in informal enterprises by sector, March 2004 (Devey et al, 2006)

On average, households spend 17.3% of their household income at informal businesses (Ligthelm, 2005). Approximately 10% is spent at retail outlets, with the informal retail trade being valued at R32 billion in 2002. Retail outlets take the form of (Ligthelm and Masuku, 2003):

- Spaza shops or tuck shops, which are businesses operated in a section of an occupied residential property.
- Hawkers or street vendors, who operate from a temporary or permanent structure on a street, taxi rank or train station.

- Township general dealers, who operate stand-alone businesses that carry a wider product range and that allow self-service to clients. They are often located in business areas, but can also be located in residential areas.

Informal transport, dominated by the taxi industry, attracted R15,9 billion of household expenditure in 2004, followed by shebeens, which attracted R8.9 billion (Ligthelm, 2005).

Merchandise sold by retailers are predominantly food products, like soft drinks, bread, cigarettes and tobacco, milk, sweets and chocolates, fruit and vegetables, sugar and maize meal (Ligthelm and Masuku, 2003).

The majority of retail enterprises are generally family businesses, tend to be survivalist and the sole source of income for a household of five people (Ligthelm and Masuku, 2003). Most were started as a result of unemployment in the formal sector. The informal sector is an important source of employment, with general dealers employing, on average, approximately four people, and spaza shops employing about two people (Ligthelm and Masuku, 2003).

Informal enterprises are predominantly cash businesses, with very few being able to secure credit terms from suppliers, who are predominantly formal businesses, for example wholesalers, mobile supplier units and manufacturers (Ligthelm and Masuku, 2003). However, businesses do commonly extend credit terms to their customers, which is considered to be a major advantage to

customers of buying from informal retailers. Ligthelm and Masuku (2003) also found that the frequency of settlement seldom exceeded one month.

Competition in the informal economy is extremely fierce. Low barriers to entry result in a large number of other informal competitors, and large formal retailers are becoming an increasing presence in township localities. The major advantages of informal businesses to customers are good, friendly service, close proximity to customer's dwellings, and long and flexible working hours (Ligthelm and Masuku, 2003). Disadvantages are high prices compared to large formal retailers and the unavailability of stock when owners encounter problems with cash flow.

The major constraints experienced by informal traders, as reported by Ligthelm and Masuku (2003) are shortage of trading stock due to lack of finance, high crime rates, severe competition, lack of customer income, high transport costs and bad debt.

The Financial Diaries project of the Finmark Trust (Financial Diaries, 2006) created six household profiles, which paint a picture of the lives of the people that are participants of the informal market. These profiles are given in Appendix A. The profiles stand testament to the wide range of income levels and living circumstances of the people that engage in informal activities.

2.2.4 Linkages between the Formal and Informal Economies

The formal and informal sectors are inextricably linked, and policy decisions and business strategies in the formal or informal sector have to consider the impacts on the other. Recognition and quantification of the linkages between the formal and informal economy allows (Naidoo, van Aardt and Ligthelm, 2004):

- Recognition that the informal sector is not independent of the formal sector and that there is a significant degree of interrelatedness. Quantification of the linkages shows that the perception that the informal sector is negligible is untrue, and that it is a significant contributor to production, employment and income.
- Identification of areas where resources should be invested to strengthen the linkages between the formal and informal sectors. This requires the identification of backward and forward linkages, not just between the formal and informal sectors, but also between formal sectors themselves.
- Understanding of the trends in the linkages between the formal and informal sectors, especially in relation to the business cycle on an industry specific basis.
- Understanding the nature of the linkages and whether they are beneficial or exploitive.

Naidoo *et al* (2003) attempted to quantify the linkages using the input – output table approach. These linkages were assessed on an industry sector basis, which offers a deeper understanding of the contribution of the informal sector to specific sectors. This type of analysis shifts the policy and business strategy discussion from a generalised view of the informal economy, to a more specific understanding of the interaction that will vary in structure, size and contribution from one industry to another.

2.3 Measurement of the Informal Economy

2.3.1 Economic Measurement

Economics has been described as the science relating to the laws of production, distribution and exchange. Within this simple definition is hidden the complexity of the economy, a space which is created not just from the variety of actors, acting optimally in pursuit of their own self interest, but also from the dynamic interactions between the actors, and between the actors and the environment. The system communicates and responds to a dynamic flux of prices, levels of production and feedback between the actors and the environment. Economic activity can be regarded as the exchange of goods and services, occurring within this complex framework.

Economic growth defines the nation's ability to produce more goods and services. Economic growth is caused by supply factors, such as increased production capacity or potential output, and demand factors, like increased domestic and export demand, and import substitution (Mohr and Fourie, 2004).

From a macroeconomic perspective, the most commonly used measure of economic growth is the Gross Domestic Product (GDP). It is defined as “the total value of all final goods and services produced within the boundaries of a country in a particular period” (Mohr and Fourie, 2004). The expenditure method of GDP measurement is defined as the sum of private consumption by households, investment spending by firms, government spending and net exports (namely, the difference between expenditure on exports and imports).

There are a number of limitations to the use of GDP, especially its inability to indicate inequality of wealth distribution and its ineffectiveness as a measure of standard of living (Mohr and Fourie, 2004). In examining the limitations of the use of GDP, it is important to note the tendency for generalised composite indicators to be expected to measure the full gamut of economic complexity, when this cannot be realistically achieved by a single number. However, it does indicate the overall level of economic activity and provides a basis of comparison, with view to it not being viewed in isolation.

2.3.2 Current Approaches to Measurement of the Informal Sector

The commonly used methods to estimate the size of the informal economy can be classified into: direct approaches, indirect approaches and the model approach, as summarised in Table 2 (Schneider, 2002).

Table 2. Methods used to estimate the size of the informal economy (Schneider, 2002)

Approach	Method	Description	Advantages	Disadvantages
Direct Approaches (micro economic)	Surveys	Usually done by direct questionnaire and interviews	Widely used Yields detailed information about the structure and composition of the informal economy	Respondents reluctant to honestly divulge fraudulent behaviour. Results sensitive to the way the questionnaire is formulated. Results in lower-bound point estimates. Do not provide growth of the informal economy over time.
	Samples	Measure the amount of undeclared taxable income by measuring the discrepancy between income declared for tax purposes and that measured by selective checks	Yields detailed information about the structure and composition of the informal economy	Biased sample of the population based on likelihood of fraud. Reveal only a fraction of the informal economy which the authorities have already discovered. Results in lower-bound point estimates. Do not provide growth of the informal economy over time.
Indirect (Indicator) Approaches (macro economic)	Discrepancy between National Expenditure and Income Statistics	Gap between income measure of GNP and expenditure measure of GNP indicates extent of the informal economy	Use published data sources collected for other purposes (Feige, 1990)	Errors in measurement of expenditure. Tendency for statisticians to minimise discrepancy. Crude and questionable reliability.
	Discrepancy between Official and Actual Labour Force	Decline in participation in the formal labour force is seen as an indication of increased activity in the informal economy	Use published data sources collected for other purposes (Feige, 1990)	Differences in the rate of participation may have other causes. People can work in the informal economy and have a job in the formal economy at the same time.

Table 2. Methods used to estimate the size of the informal economy (Schneider,2002)

Approach	Method	Description	Advantages	Disadvantages
	The Transactions Approach	Difference between the official GNP and nominal GNP, which is determined by calculating the volume of transactions.	Theoretically attractive.	Difficult empirical requirements to obtain reliable estimates.
	The Currency Demand Approach	Correlation between currency demand and tax pressure. Informal transactions are cash transactions that increase demand for currency.	Commonly used.	Not all transactions in the informal economy are in cash. Tax burden seen as the only cause of the informal economy. Other reasons for currency demand increases. Assumes same velocity of money in the formal and informal economies. Assumption of no informal economy in the base year.
	The Physical Input (Electricity Consumption) Method	Ratio of electricity consumption as to GNP, from a base year	Electricity is a basic production input The income elasticity of electricity relative to GNP can be calculated easily (Portes and Schauffler, 1992)	Not all informal activities require considerable amounts of electricity and other energy sources can be used. Greater efficiency in production and use of electricity due to technological innovations. There may be considerable differences or changes in the elasticity of electricity/GDP across countries over time.
The Model Approach		Explicitly considers multiple causes leading to the existence and growth as well as multiple effects of the informal economy over time	Detailed analysis	Very data intensive. Time consuming and costly to implement.

2.3.3 The Design of Economic Indicators

Surveys and samples are commonly used microeconomic methods of measuring the size of the informal economy. They are found to result in lower-bound point estimates, and do not provide growth of the informal economy over time. An indicator is a means of aggregating the data collected from the surveys and samples, as well as other sources, into a single term that will allow comparison with other geographic areas, and allow monitoring of economic activity with time.

An indicator can be defined as “a quantitative or a qualitative measure derived from a series of observed facts that can reveal relative positions in a given area. When evaluated at regular intervals, an indicator can point out the direction of change across different units and through time” Organisation for Economic Co-operation and Development (OECD) (2005, p8).

However, a single indicator would not be sufficient to capture the complex, multi-dimensional nature of the informal economy. A composite indicator is a compilation of a number of individual indicators into a single index, based on an underlying model OECD (2005). The advantages and disadvantages of the use of composite indicators are highlighted in Table 3.

Table 3. Advantages and disadvantages of composite indicators (OECD, 2005)

Advantages	Disadvantages
<ul style="list-style-type: none"> • Provide a summary of complex or multi-dimensional issues to aid decision makers. • Easier to interpret a trend in one indicator than many separate indicators. • Facilitates the task of ranking regions on complex issues in a benchmarking exercise. • Can assess progress over time on complex issues • Places the issues of performance and progress at the centre of the policy arena. • Facilitate communication and promote accountability. 	<ul style="list-style-type: none"> • Poorly constructed or misinterpreted composite indicators may send misleading policy messages • May invite simplistic policy conclusions • May be misused. For example, it is used to support a desired policy if the process of construction of the indicator is not transparent and it lacks sound statistical or conceptual principles. • The selection of indicators and weights could be the target of political challenge. • May disguise serious failings in some dimensions and increase the difficulty of identifying appropriate remedial action. • May lead to inappropriate policies if dimensions of performance that are difficult to measure are ignored.

There is growing use of composite indicators among policy makers and academics, resulting in a range of methodologies being used to develop these indicators OECD (2005). The Organisation for Economic Co-operation and Development (OECD) developed a handbook that aims to provide an international guideline in this domain (OECD, 2005). It provides a ten step programme to designing composite indicators OECD (2005):

1. *Developing a theoretical framework*, to provide a conceptual basis around which the individual indicators can be selected, and meaningfully combined, in a way that is fit for its original purpose.

2. *Selecting variables*, based on their analytical soundness, measurability, country coverage, relevance to the phenomenon being measured and relationship to each other.
3. *Multivariate analysis* as an exploratory analysis to investigate the overall structure of the indicators, assess the suitability of the dataset and explain the methodological choices.
4. *Imputation of missing data*, to ensure that different approaches for imputing missing values are considered, especially since extreme values could become unintended benchmarks.
5. *Normalisation* of data to render them comparable.
6. *Weighting and aggregation* of the indicators according to the underlying theoretical framework.
7. *Robustness and sensitivity analysis* as a mechanism to include or exclude an individual indicator, and to assess the normalisation scheme, the imputation of missing data and the choice of weights.
8. *Links to other variables*, to allow correlation of composite indicator with other published indicators, as well as to identify linkages through regressions.

9. *Presentation and dissemination* should be considered since indicators can be visualised in a number of different ways which can influence their interpretation.

10. *Back to the real data*, where the composite indicator can be decomposed into its underlying indicators or values.

Within this context, this study represents Step 1 in this process of indicator development, that is, to develop a framework of understanding of the phenomenon of the informal economy that is to be measured. Although newly emerging policy areas may not have solid theoretical and empirical underpinnings, OECD (2005) stresses transparency in the process of indicator development as an essential element in building credibility. They advise on the following as a means of overcoming “what is badly defined is likely to be badly measured” (OECD, 2005, p12):

1. *Defining the concept*. There should be a clear and precise understanding of what is being measured by the composite indicator.
2. *Determining the subgroups*. When faced with multi-dimensional concepts, these can be divided into several subgroups. Although these subgroups are not required to be independent of each other, the linkages between them should be described, either theoretically or empirically.

3. *Identifying the selection criteria for the underlying indicators.* The selection criteria should serve as a precise guide to determine whether an indicator is to be included in the index or not. It is important to have a thorough understanding of what is being measured, and whether it represents an input, output or process measure.

Within this framework, the development of an indicator requires a clear and precise conceptual model that describes the various elements of the concept being measured, how these elements interact with each other, what exactly it is that the indicator is measuring and what does the indicator tell you about the state of the total system. The development of a theoretical framework is therefore a critical first step and is discussed further in Chapter 5.

2.4 Conclusion

The informal economy has been recognised as a significant component of the total economy, especially in developing countries, and numerous techniques have been developed to measure its size. The informal market has also been extensively profiled in South Africa. The steps to be taken along the road to indicator development for the informal market have been defined. The remainder of this report focuses on the first step, that of developing a conceptual model for the informal economy.

CHAPTER 3 RESEARCH QUESTIONS

The review of the current literature on the informal economy demonstrated that, although the market was profiled extensively, these tend to give a snapshot perspective of the market, and do not capture the dynamism of these markets as they adapt and change in response to changing environments. The definitions of the informal economy are comprehensive and view the informal economy from a macro context. However, there are no strong theory bases that provide an adequate framework to describe the workings of the informal market from a micro economic perspective.

The first step, before indicators can be developed, is to have a theoretical understanding of what is being measured. This framework will provide an understanding of the phenomenon of the informal market, its various elements and how those elements work and interact to grow and develop the informal market. Indicators can be developed to measure each of these elements and interactions to paint a picture of the market, not just at a moment in time, but also as it changes with time. The model can provide a basis to predict how the market is likely to react to changes and to gain a holistic understanding to drive better decision making.

The predominant research question is therefore:

Which theoretical framework can be applied to describe the informal market?

Further, within the context of indicator selection, the second research question is:

How can this framework be used to develop indicators for the informal market?

CHAPTER 4 RESEARCH METHODOLOGY

4.1 Introduction

In response to the research questions posed in the previous chapter, the research methodology adopted in this study is described. A qualitative approach was adopted, using a series of expert interviews, to explore the informal market from a measurement perspective. At the same time, an extended review of literature in other disciplines was undertaken to develop a theory base that could be adapted to the informal market.

4.2 The Research Approach

The research approach was exploratory, since no explicit model for the informal market was found that could be used as a basis for developing indicators. The approach was therefore twofold, though each of these legs proceeded in parallel:

- Further examination of the literature to find theoretical approaches in other disciplines that could be adapted and applied to the informal market
- An exploration of the experiences and perspectives held by experts, who have direct experience with the informal market, to contextualise the theory base to the informal market.

The exploration into this topic, although structured around these two research legs, was also informed by exposure to various academic discourses, the media

and informal discussions around various topics, related and seemingly unrelated to the topic of informal markets. The process of idea generation is not linear or structured, and follows from a process of formal and experiential learning. This learning is not just a function of the present research focus, but also a function of past experiences that have contributed to the researcher's particular world view.

4.3 Expert Interviews

The objective of the expert interviews was to understand the participants' thoughts and ideas on the drivers of economic activity in the informal sector, within the context of their personal experiences. The use of unstructured interviews provided the flexibility needed to follow new lines of enquiry that were promising, and to probe the participants to provide more detail or to clarify certain responses. "In unstructured interviews, attempt is made to understand how individuals experience their life-world and how they make sense of what is happening to them..... the interviewer focuses on participant's first hand experience of their life-world, rather than their interpretation or speculative explanation of it" (Welman and Kruger, 2001, p. 188).

The population of relevance consisted of people who have a known or demonstrable expertise and experience in the informal economy. The study used purposeful snowball sampling to generate a sample of five experts. The sample size does not claim to be representative or statistically rigorous. It is based on the availability of participants, their willingness to participate, and the

scale and scope of the study. Individuals were identified who have particular interest and experience in the informal economy, who then recommended other individuals in the population. An overview of the sample is given in Table 4. It lists the participants of the study, the chronology of data collection and the date and place of data collection.

Table 4. An overview of the research sample

No.	Participant	Qualification for Participation	Date and Location of Interview
1.	Ekow Duker (ED)	Employed in the Banking sector developing strategies for low income markets	21/08/06 at Standard Bank, Johannesburg
2.	Prof. Andre Ligthelm (AL)	Economist and academic who has published numerous reports and articles on the informal economy in South Africa	20/08/06 at the Bureau of Market Research, UNISA,, Pretoria
3.	Arthur Risenga (AR)	Economist and researcher who was once a hawker in the informal market and who has an intimate knowledge from living within the informal economy.	04/09/06 at the Bureau of Market Research, UNISA,, Pretoria
4.	Vincent Seoka (VS)	Director of a market research company specialising in informal markets, with an intimate knowledge from having grown up, lived and worked extensively in informal markets	13/09/06 at Kutu Consulting, Randburg
5.	Anthony Prangley (AP)	Geographer and anthropologist, with a keen interest in the urban informal economy, and the development of experiential learning programmes to teach business executives about informal markets.	19/10/06 at the Gordon Institute of Business Science, Illovo

Primary data was collected by interviewing the sample of experts in an unstructured and conversational style. The following questions were open

ended and were used to elicit rich and detailed explanations of the participants' thoughts and experiences, structured around the research questions posed:

1. Participant's level of contact and involvement in the informal sector.
2. What does the participant consider to be the important variables contributing to economic activity in the informal economy?
 - o If the economy was in growth, or in decline, what would the changes that would be noticed?
3. What is the participant's justification for selecting these variables?
4. The participant was asked to identify other experts and what qualifies these experts to the population selected.

The interviews were recorded and transcribed. Content analysis was done on the data collected. As the interviews were being conducted, the theory was being developed based on an extended literature review. The experience of interviewing, where views and ideas were shared, stimulated and refined the literature review for an applicable theory base. The categorisation of the data was informed by the theoretical framework.

This research is limited in that the sample is small and the results cannot be generalised in any way. Questions were focused on informal economic activity and would be biased against other types of activities. The experts could be wrong. Researcher bias will exist.

4.4 Conclusion

The research design and methodology are suited to answer the research questions posed, within the scope and time limitations of this study. The limitations of the study are recognised. The chapters that follow explore the theoretical underpinnings of this study, and how the data collected supports the application of this theory to informal markets.

CHAPTER 5 A THEORY BASE FOR INFORMAL MARKETS

5.1 Introduction

This chapter justifies the use of theories on sustainable development and systems thinking as a basis for characterising informal markets. It introduces the concept of sustainable livelihoods, as a means of describing how communities interact and work, and introduces a systems approach to the development of indicators.

5.2 An Alternative Viewpoint

There are no existing theoretical frameworks that conceptualise the workings of the informal economy. The informal economy is poorly understood, and most indicators currently employ survey methods to characterise the informal economy, predominantly by employment and household spending characteristics. These indicators are based on a reductionism philosophy of market economics. However, this paradigm, which may accurately model the behaviour and patterns of the formal economy, is thought to be inadequate for the informal economy. It is because of the incompatibility of this dominantly held worldview that informal markets have, up to now, been largely ignored.

The very first interviewee, who represents the business perspective, said:

"..nobody really can disprove that if we are doing something that is merely to extract from the community without building it up,.. the profit [by] itself [will] be unsustainable. To me it is more about what drives the economic engine...It

is not enough to launch a product.... But you have to think of what else I can do within the community to reinforce this economic engine." (ED)

He later goes on to say that:

"when you get to an informal community then the rules at the micro-level break down, and they should break down." (ED)

In his presentation of 'Capital Formation in Informal Markets', Jonker (2006) suggests that informal markets cannot be characterised by the conventional economic view that dominates our paradigm of formal markets. Informal markets, by their very nature, operate by a different set of rules that requires us to question our current worldview. Informal markets, by the very fact that they are informal, do not conform to accepted rules that govern business in the formal sector.

In the formal sector, these rules have been accepted and institutionalised to the extent that they are 'invisible'. For example, De Soto (2000) highlighted the use of capital in Western formal markets, and the inability of many developing nations to benefit from capitalism because of their inability to produce capital. The capital exists, but it is not recognised, recorded and used as an instrument in the way western markets take for granted.

Informal markets are different from formal markets in that transactions are largely unrecorded, relationships between buyers and sellers are more personal, the flow of information is across a shorter range, response to change is quicker

and there are few formal controlling mechanisms. As a result, the economic system cannot be viewed as a discrete and separate entity from the social system, for example, as it is possible to do in the formal economy. In the formal economy, depersonalisation and 'distance' is brought about when documents and signatures are used to represent people and the relationships between them.

It emerged from the initial findings of the expert interviews that, even though traditional economic indicators were identified, for example number of informal and formal enterprises, formal and informal employment, household income and consumer expenditure, there was also a consistent identification of other indicators, like levels of education, standard of living, type of housing, infrastructure, government programmes and mindsets. It is impossible to have a conversation about the informal economy without including factors outside the traditional economic realm.

For informal economies to thrive, they must grow and develop organically. They must be sustainable – growth, and the benefits of that growth, must permeate all realms of the community, making it stronger and reinforcing the virtuous cycle of growth and development.

5.3 The Sustainable Development Approach

The field of sustainable development emerged from the environmental sciences. As environmental issues began to take a global scale with concerns about the depletion of resources overtaking the ability of the natural systems to restore

them, the concept of sustainable development came to the fore. Something is seen as being sustainable “when it can continue into the future, coping with and recovering from stresses and shocks, while not undermining the resources on which it draws for existence” (DFID, 1999).

Thinking in sustainable development began to take a more holistic view, from an ecosystem sustainability standpoint, to one which views the entire world as a system. The ecosystem is just a part of this system, which comprises of a number of other subsystems, for example, the human system and the geophysical system. These systems are not distinct and separate, but interact with each other in complex and often unknown ways. Each system has to be in balance and harmony within itself, with its environment, and with other systems, for the whole earth system to be viable.

On a more micro, community level, the concept of sustainable development began to take a more anthropogenic focus with the development of concepts like ‘sustainable rural livelihoods’. These concepts began to see the convergence of environmental management with poverty reduction and rural development.

The concept of sustainable livelihoods is introduced first. It provides a framework of understanding how communities, especially impoverished ones, make decisions, within their context, to utilise their available assets to achieve their own specific outcomes.

This is followed by an introduction to the systems thinking perspective to sustainable development, which provides a framework for the development of indicators for sustainable development.

5.4 The Sustainable Livelihoods Framework

Although originally conceived as a rural development framework, the concept of sustainable livelihoods cannot be limited to the rural context with the strong interactions between rural and urban livelihoods. The term livelihoods is defined by DFID (1999) as follows: “A livelihood comprises the capabilities, assets (including both material and social resources) and activities required for a means of living. A livelihood is sustainable when it can cope with and recover from stresses and shocks and maintain or enhance its capabilities and assets both now and in the future, while not undermining the natural resource base.”

The sustainable livelihoods framework provides a way of thinking that identifies the main factors that influence the livelihoods of the poor, and maps how these interact with each other. The framework is illustrated in Figure 8. It places people within a context or environment, referred to as the ‘Vulnerability Context’ that exerts influence on the community that is usually out of their direct control. These could include environmental shocks, like droughts, seasonality of prices or more long term trends in technology and governance (DFID, 1999).

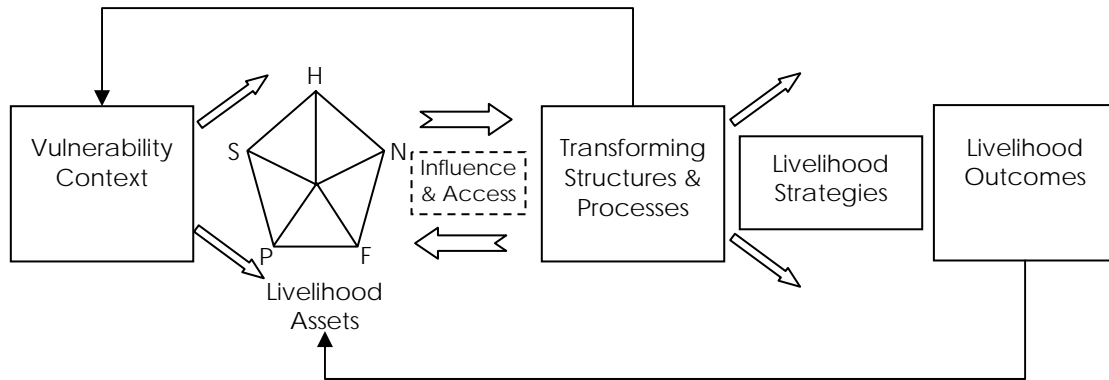


Figure 8. The sustainable livelihoods framework (DFID, 1999)

Livelihoods are built around five core asset categories that are represented by a pentagon (DFID, 1999). These are used to represent people's strengths and how these can be combined in innovative ways to achieve positive livelihood outcomes. They represent the potential that is latent within the community that can be converted to achieve certain outcomes. The five livelihood assets described further below (DFID, 1999):

- **Human Capital** represents the skills, knowledge, good health that provides the capacity for individual members of the community to achieve their livelihood strategies.
- **Social Capital** is developed through networks and connectedness, which increases trust and the capacity to work together, increases access to wider institutions, including membership to formalised groups, reduces transaction costs and provides a safety net in times of difficulty.

- **Natural Capital** represents natural resources which are used for achievement of livelihood outcomes, for example, land, water, forests and air. These are used for consumption, production and waste disposal.
- **Physical Capital** includes all physical infrastructure that allows people to be productive, for example structures for transport, communication, energy supply, water supply and buildings. It also includes tools and equipment for production.
- **Financial Capital** represents the cash or cash equivalents that people have available to support achieve their livelihood objectives.

Institutions, organisations, policies and legislation operate at all levels to shape livelihoods. These are termed 'Transforming Structures and Processes'. Structures represent the 'hardware', actual private and public sector organisations, like government institutions, judicial bodies, commercial enterprises and corporations, civil society and NGOs (DFID, 1999). The processes represent the 'software' which dictates how the structures operate and interact. Processes include policies, legislation, informal practices and agreements ('the rules of the game'), culture and the power relations within the society (DFID, 1999).

A livelihood strategy is a broad term that describes the range of activities that people undertake and the choices that they make to achieve their livelihood goals (DFID, 1999). These goals can include, among others, productive

activities, investment strategies and reproductive choices (DFID, 1999). Livelihood outcomes are the 'output' of this system, and it describes these goals. It is important to recognise that these goals are what motivate people to behave as they do; it represents their priorities in their lives and determines how they are likely to respond to new opportunities (DFID, 1999).

The transforming structures and processes are a very important element of the system, which has influences and feedback loops to other system elements. The direct feedback to the vulnerability context demonstrates the ability of policies implemented through structures, to change trends or help cushion the impact of shocks (DFID, 1999). Institutions can restrict people's choice of livelihood strategies and may also directly affect their livelihood outcomes (DFID, 1999). As people achieve their outcomes, for example, increased income, they invest in livelihood assets, thus reinforcing the community structure.

5.5 Systems Thinking in Sustainable Development

The informal economy cannot be viewed as an end in itself, but rather as a subsystem within a larger societal system. On the micro-economic level, "the community is the smallest cell of human interaction that contains all the vital subsystems that we find in the larger units (cities, states, nations) of human society" (Bossel, 1999, p85).

5.5.1 Indicators within a systems context

Indicators are the centre of the decision making process, and they arise from our values (we measure what we care about), and also create values (we care about what we measure) (Meadows, 1998). Decisions are made based on information that is available on the perceived state of the system (Figure 9), usually provided by indicators (Meadows, 1998). An action is then taken to bring the system condition to some desired state or goal, which then alters the functioning of the system.

Indicators therefore enable us to improve the system. Misleading indicators cause over- or under-reactions that will not bring about the desired state (Meadows, 1998). Indicators are therefore used to steer the system to keep it on the desired track (Meadows, 1998).

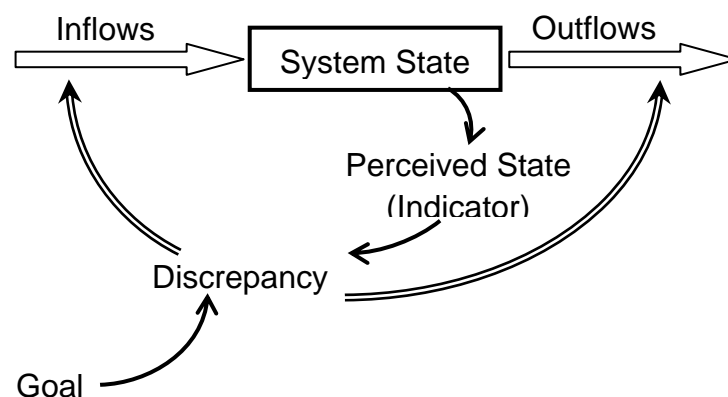


Figure 9. A generic system flow diagram (Meadows, 1998)

It is important to keep in mind that indicators are not complete reflections of reality, and that they are based on models that are at best uncertain and

imperfect. Meadows (1998, p6) states this implicitly by saying “No indicator is the real system. Indicators are abstractions from systems. Furthermore, they are abstractions from abstractions, from models or sets of assumptions about how the world works, what is important, what should be measured.”

Indicators are firmly based on the model that is used to understand the system. It is a model that represents a particular world view, the purpose of which is to simplify complexity and reduce uncertainty. In the sustainable development context, there are many different purposes and world views that drive the global system and the decisions around it, and so it may not be possible to have a single global measure to describe sustainable development (Meadows, 1998). In this case Meadows (1998) proposes an information system of indicators. The model then serves to organise and link together this information system of indicators.

It is possible that the same may be true for informal markets. When viewed as a system, the informal market cannot be viewed in isolation. It is a complex adaptive system that is interconnected with and forms part of a larger societal system composed of, for example, environmental, technological, political and psychological systems. It may be that a single indicator will not be pertinent, but this element will have to be explored further.

5.5.2 Basic System and Environmental Elements

On the micro-economic level, the societal system can be seen to be composed of the following sub-systems (Bossel, 1999, p17), which interact as shown in

Figure 10: Individual Development; Social System; Government System; Infrastructure System; Economic System; Environment and Resource System.

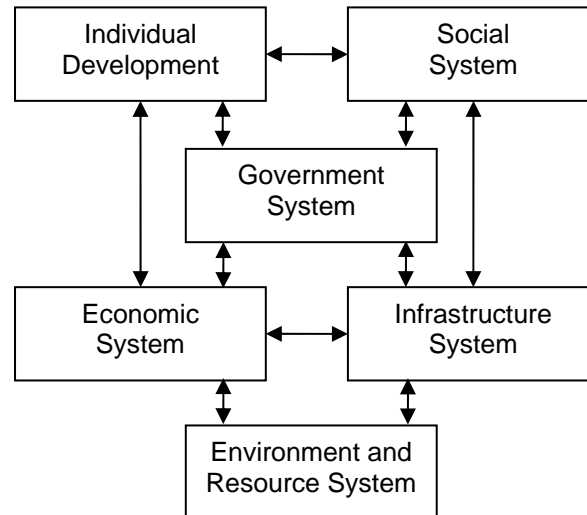


Figure 10. The major relationships between the elements of the societal system (Bossel, 1999)

In the informal market, each of these systems can be viewed as having a certain degree of potential that can be harnessed to bring about the overall health of the entire community. This potential can be viewed as capital or a stock of a vital asset, that can appreciate or depreciate, but which must be maintained in a healthy state in order to contribute its share to the health and development of the entire system (Bossel, 1999).

The term 'viability' is used to describe the ability of the system "to survive, be healthy and develop in its system environment" (Bossel, 1999, p24). The system environment is a critical component of systems analysis. Systems and their environments co-evolve. The environment imposes certain requirements

and restrictions and the system orients its functions and behaviour in response (Bossel, 1999).

The viability of a system is a function of the system itself and its ability to adapt to its environment. Bossel (1999) describes the fundamental properties of both systems and system environments (Table 5). Figure 11 illustrates this dynamic interaction between a system and its environment. Indicators would help us determine how the basic system needs or basic orientors are satisfied within a given environmental context (Bossel, 1999).

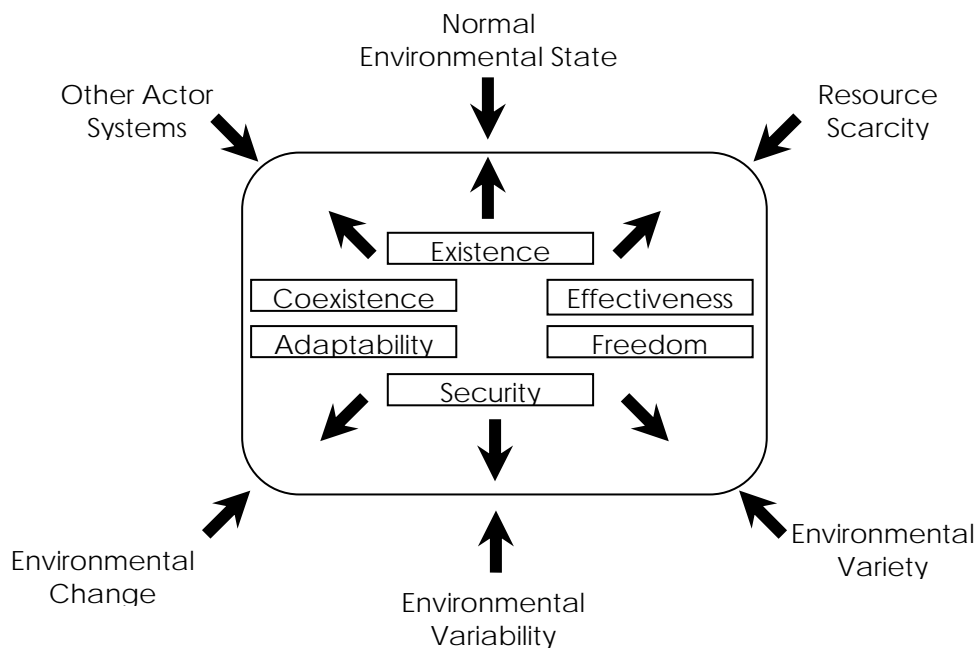


Figure 11. Fundamental properties of system environments and their basic orientor counterparts in systems (Bossel, 1999)

The figure shows that particular environmental conditions bring about certain responses in the system, for example, in the condition of resource scarcity, the system is required to be more effective in its use of resources in order to

remain viable. These environmental properties and corresponding system orientors are described in detail in Table 5.

In addition to the environment determined orientors, Bossel (1999) also describes three system determined orientors. The properties of the system itself impose certain orientations. These are (Bossel, 1999):

Reproduction: Self-reproducing systems must be able to reproduce.

Psychological needs: Sentient beings (animals and humans) have psychological needs that must be satisfied.

Responsibility: Conscious beings (mainly humans) can reflect on their own actions and impacts, and are responsible for the conscious choices that they make.

Table 5. Basic system responses to environmental conditions (Bossel, 1999)

Property of the system environment	Corresponding basic orientor of the system
Normal environmental state: The actual state can vary around this state in a certain range.	Existence: The system must be compatible with and able to exist in the normal environmental state. The information, energy and material inputs necessary to sustain the system must be available
Resource scarcity: Resources (energy, matter and information) required for a system's survival are not immediately available when and where needed.	Effectiveness: The system should on balance (over the long term) be effective (not necessarily efficient) in its efforts to secure scarce resources (information, matter, energy) and to exert influence on its environment
Variety: Many qualitatively different processes and patterns of environmental variables occur and appear in the environment constantly or intermittently.	Freedom of action: The system must have the ability to cope in various ways to the challenges posed by environmental variety
Variability: The state of the environment fluctuates around the normal environmental state in random ways, and the fluctuations may occasionally take the environment far from its normal state.	Security: The system must be able to protect itself from the detrimental effects of environmental variability, that is, variable, fluctuating and unpredictable conditions outside the normal environmental state
Change: In the course of time, the normal environmental state may gradually or abruptly change to a permanently different normal environmental state, that is, it shifts to a different normal environmental state.	Adaptability: The system should be able to learn, adapt and self-organise to generate more appropriate responses to challenges posed by environmental change.
Other systems: The environment contains other actor systems whose behaviour may have system-specific (subjective) significance for a given actor system.	Coexistence: The system must be able to modify its behaviour to account for behaviour and interests (orientors) of other (actor) systems in its environment.

These principles are applicable to all systems. In the case of the community, each subsystem must be viable in terms of its basic orientors in order for the whole system to be viable. It is important to note that all the orientors may not be equally important to system success, but a certain minimum level of each orientor is essential for basic viability (Bossel, 1999). Similarly, in the community, there may be certain subsystems and relationships that the system is more dependent on for its viability.

The system's development will be constrained by the basic orientor that is in the minimum (Bossel, 1999). First, minimum satisfaction must be obtained separately for each indicator (Bossel, 1999). Only if all the orientors are satisfied to a minimum level, can you improve the system satisfaction by further improving specific orientors (Bossel, 1999).

Indicators would provide information on how the basic system needs are being satisfied under a particular set of environmental circumstances. The indicator system must be clear about which orientor or environmental property it is providing information for. Each orientor must be analysed and defined clearly before indicators can be defined.

Each of the six societal elements illustrated in Figure 10 is a separate system in itself. For each individual system, basic orientors will have to be analysed and defined. In addition, the interactions between orientors within the system will have to be understood. Even though the orientors may be unique, they

nonetheless may be dependent on each other to reach a certain level of satisfaction.

5.6 Conclusion

The sustainable livelihoods framework provides a systematic description of the various elements of a community, and how these elements' complex interactions can be analysed. It configures the community network in terms of meeting individual, and group needs. These needs are met using a strategy that is a function of the individual's own values, culture and preference. This framework allows consideration of a specific community or market as being unique. The introduction of products and services to an informal market must be viewed in context of people's own livelihood strategies, and how these products will assist them in achieving their own livelihood outcomes more effectively.

The entire community system is dynamic, and the dynamism can be represented by measuring the various elements and interactions with time. The systems approach ensures that all essential elements of the system as a whole are taken into account, and that a basic level of viability is achieved to allow the whole system to achieve its objectives. Indicators allow us to orient ourselves to these goals, and allow us to make changes in the system and in its environment, to achieve these goals more effectively.

CHAPTER 6 A CONCEPTUAL MODEL FOR THE INFORMAL MARKET

6.1 Introduction

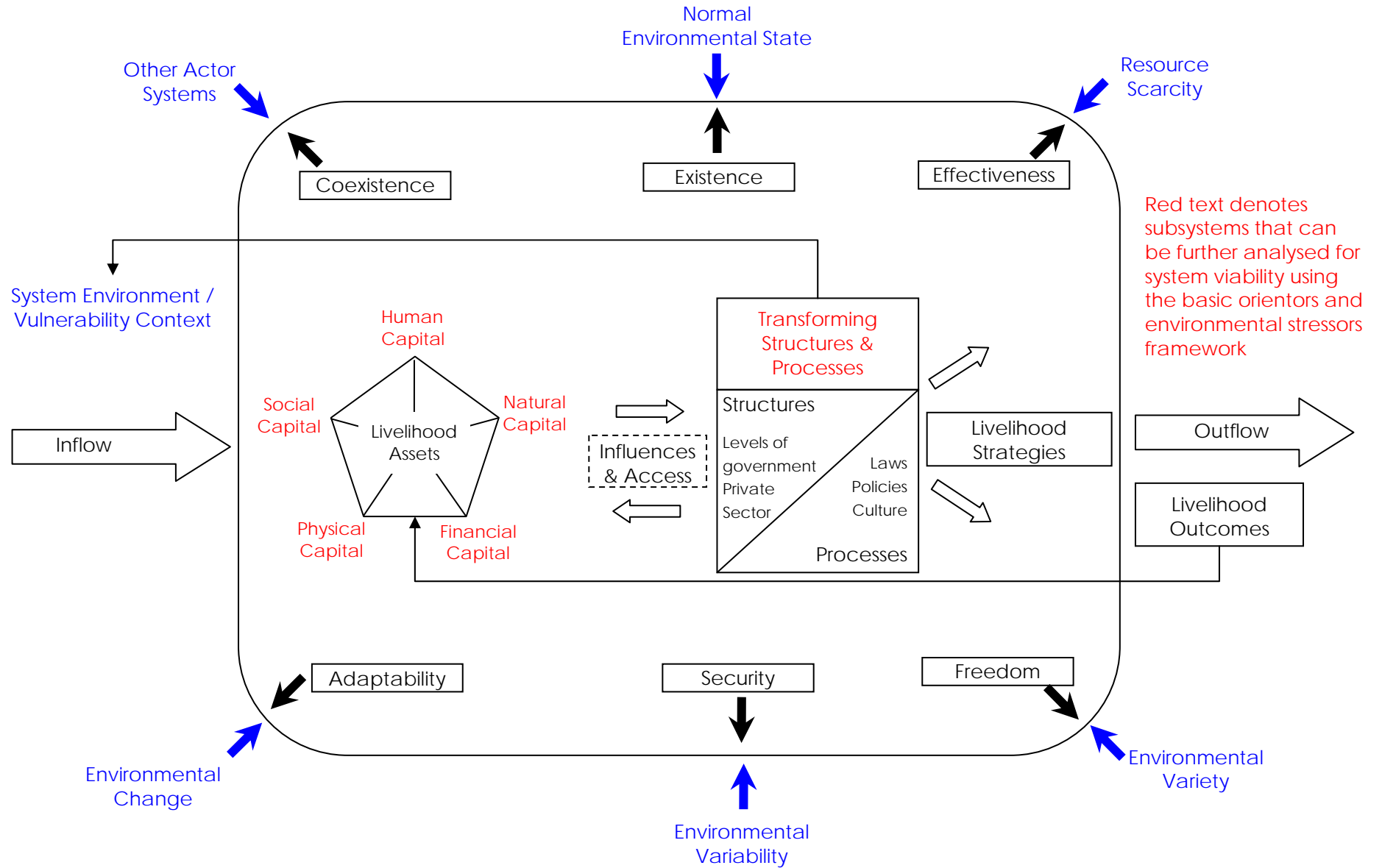
The theory presented in the previous chapter is combined to propose a model for the informal market. This model is then applied to analyse the data acquired through the expert interviews. The data confirms the applicability of the model to the informal market, and the model is then used to propose a high level framework for indicator selection.

6.2 A Proposed Model for the Informal Market

Using the community as the unit of analysis, the livelihoods framework is seen to represent the total community system, as illustrated in Figure 12. This system exists within an environment that exerts certain influences on it, and the community itself adapts and orients itself in response to these stressors from the environment.

Assets are stocks of human, financial, natural, physical and social capital that exist within the community. The inputs to the community model are changes to the various assets with time. The transforming structures and processes represent the process of converting those assets into livelihood outcomes for the community, which can be seen as the system output. The processes are guided by the livelihood strategies of the community. The system is complex and there are a number of feedback loops and interactions. Each element retains the same definition as discussed in the theory in Chapter 5.

Figure 12. A proposed conceptual model for the informal market



6.3 Data Analysis Using the Sustainable Livelihoods Framework

The data from the interviews was used to understand the informal economy from a sustainable livelihoods perspective. A synthesis of the data collected and the literature studied provided the basis for the analysis presented.

6.3.1 Environmental Conditions

DFID (1999) views the environmental conditions affecting livelihoods of communities as a “vulnerability context”. Although environmental conditions may have positive or negative influences, the term acknowledges the fact that the poor have less influence to manipulate their environment, making them vulnerable to environmental stresses. Further, the poor often do not have assets or institutions that allow them to benefit from positive environmental trends.

The interviewees acknowledged that:

“Impacts on communities can be from far away” (ED).

Further, the cause of the second economy is viewed as the failure of the formal societal system to provide the support required for the poor to lead functional lives. One interviewee suggested that an indicator of a lack of opportunity in the formal sector would be a visual indicator of seeing less people early in the morning:

“.. people no longer wake up because there are no longer jobs for them” (VS).

However, one interviewee presented the scenario beyond just the second economy being just the safety net of the poor, where the failure of the formal economy could lead to a much larger scale of informal activity:

“the kind of environment, business environment deteriorates there is corruption, the deterioration of roads, you can’t get any services done, your phone takes long to be fixed, you know, that kind of environment which I think would also drive people to the informal sector, the kind of Nigerian type scenario” (AP).

People are able to exercise the least amount of control over environmental changes, but there is a feedback from the system to the environment, where changes in the community system are able to impose changes onto the external environment. Most likely these are changes in the institutional and policy environment, for example a one child policy, significantly influences demographic trends.

The formal system is an actor system that has significant influence on the informal market. It requires the informal market it to adjust itself to maintain coexistence with the formal market. Often this manifests as an increase in survivalist business activity. If security of the system is considered, then the introduction of insurance products to the informal market reduces the fragility of the market to environmental variability. Although all the environmental stressors have not been addressed, the data does provide some evidence of how environmental conditions can be analysed for informal markets.

6.3.2 Social Capital

Social capital is seen as the glue that binds the community together. An environment of trust reduces the cost of business in the informal economy. For example, most informal businesses are:

“usually family businesses – most of the household is involved [with the] father usually [being] the owner, kids usually involved in stocktaking, packing shelves, etc” (AR).

Networks and the way people interact with each other provide a powerful vehicle for marketing within the informal market

“Word of mouth...that’s what makes very strong marketing element that works in the informal sector” (AR).

Social capital also allows businesses to build strong local brands that give them a competitive advantage to enable them to succeed in the long run:

“But there are a lot of strong bonds that keep people to those kinds of traders. If they are getting a good service and there is something that’s about building social capital in buying from your next door neighbour who sells cool drinks rather than going across to the Pick n Pay” (AP).

“...those businesses that succeed in the township probably become pretty formal businesses – restaurants, butcheries, based on very good community relationships... there is something, people develop a love for them, for the

brand, so to speak, that's beyond who they really are and I think there are businesses that are able to mobilize the community in a certain way to really support them. I do see businesses that really thrive through the community relationships they have, how they have done that, I'd be very nervous to set up a business in one of those places because do you blunder in and go alone or do you work through all the politics or do you, how do you navigate this world, its very complex" (AP).

Stokvel activity was also identified by the interviewees as a social savings mechanism that increases as the informal market becomes more active. It is not limited to the lower income groups, and contributions can range from R100 per month among 5 people, to up to R3000, as indicated by one interviewee:

"I know that a friend of mine was in a stokvel where they were [contributing] R3 000 eachso you see what kind of money we are talking about. Month end the group [has] R30 000 and you can go and spend it the way you want to, and next month the R30 000 [goes] to the next person just like that. But you have to choose people that you are 100% sure of, [that] if month end comes they won't come and tell you stories" (VS).

Stokvel activity is not just an indicator of social capital, but the ability of members of the community to trust each other in such savings schemes also enhances the financial capital of the community. In spite of the large amounts of money saved through stokvels, the money is currently used to purchase consumer items, and not as a vehicle to provide capital for businesses.

Livelihood assets cannot be viewed in isolation, and there are a range of interactions between asset classes that may change from one community to the next.

Social capital can also be represented by the presence of positive role models within the communities. This is especially applicable to the youth and the motivational factors that guide their decision making.

"...there are people who obviously got successful as a result of being inspired by other persons or businessman within the township....you find maybe a young [person] coming to the townships they look up at criminals and they are quite successful criminals who, they look up at them and hey, crime pays... one other problem you find that a graduate who has done his 3 years degree but can't find employment [and they think] I don't want to end up like him and that has got quite a tremendous impact to the youth and also some other people" (AR).

Social capital is not always positive. DFID (1999) recognises that people that are excluded from strong groups may be disadvantaged, that networks that are coercive or hierarchical may limit people's ability to escape poverty, and that although membership to a network may provide one with the right to call upon others for assistance, it also ties people to the obligation to help others when they themselves might be experiencing difficult times.

In the informal market, one interviewee observed that the social network locked people into a mindset and provided a comfort zone that stifled innovation and entrepreneurship:

“local people in Alex don’t start businesses. They tend to survive on their networks, family networks, drink, complain or get a job here cleaning houses or get a good job” (AP).

Sometimes, having no network at all frees people to go about their business unhindered:

“I think your social networks, your health, your loving upbringing you know, I think they do help....In Alex for example, social networks I don’t think necessarily drive people to [do better]. Having no social networks is the biggest motivator to go out and start. [But] maybe on the other side if you were beaten down and you [were] begging and that’s it for you, then its going to be difficult to start something and make it happen so its kind of an interesting interplay. You see social networks can be affirming and [can] pull you down if you’re at a funeral every weekend and paying money for this. It will be interesting to see an entrepreneur that has all that social burden that they carry versus the person who arrives from Zululand. They can work 12 hours a day every day, their wives aren’t there, their kids aren’t there... it would be interesting to look at that with people who have those social ties who are at funerals, who are at weddings, who with social interaction, [it] becomes harder to work because of the burdens of the community places on you” (AP).

Further, social networks can be strong resistors to change, even if that change is positive and can be of benefit to the community. This resistance can be a function of history, as the interviewee quoted below pointed out, and it demonstrates the theory that all complex systems have a history (Cilliers, 1998), and our understanding of the system would be incomplete without an understanding of the events and experiences that came to shape that community to what it is now:

“My theory on Alex after watching the Alexandria Renewal Project, which is this big government project for the area, where they try to uplift the community, is that in Alex, the social ties of Alex and perhaps of other, particularly black urban communities, maybe also rural [communities], is that the social bonds [were] developed to resist the apartheid system, so they don’t like to change, so its almost an institution in the township that doesn’t want to change, it resists change. Even if the change is positive or negative they will resist and you can’t, you push this way and someone fights with you and you push that way and someone fights with you and you can’t. You end up giving up or you end spending the money all over the show and fix a road with a billion rands but you never really transform or make a big difference with the money you had, which is what government I think is finding” (AP).

Social networks can be affirming, providing support and facilitating the dissemination of knowledge. On the other hand, social networks can also be a drain on community resources. The analysis of social capital must therefore be weighed between these to gain an accurate assessment of the strengths and

weaknesses of the market. It is also important to be sensitive to the history of the community, since this drives the collective mindset.

6.3.3 Human Capital

Human capital describes the knowledge, skills and ability of individuals within the community to enable individuals to pursue different livelihood strategies in pursuit of their livelihood outcomes. All the interviewees considered levels of education to be important in characterising the informal economy. One interviewee once earned a living as a hawker, but

"I had other plans, I mean, I was going to school so I had a much broader picture of where I wanted to see myself" (AR).

Health is also an important consideration:

"I think AIDS is devastating, it tires people out" (AP).

The size of population is also considered an important indicator of the size of the market in an area. One interviewee mentioned the amount spent on alcohol as an indicator of hard times and people's inability to cope.

People's mindsets emerged as an important element of the successful growth of the informal economy through entrepreneurship. People's history and experiences have a great impact on individual mindsets and on their choice of livelihood strategies, based on what they believe they can or cannot do:

"I mean it begins with the mindset, I mean if you have a change of mindset that's one other fundamental factor that would motivate a person to do something. I mean if I previously couldn't find a job what else could I do knowing that, should I open the business here, in the previous years, the police would come and arrest me" (AR).

A lack of training and basic business skills was recognised as a major stumbling block for businesses to survive. VS recounted that in the mid-1990s, when the business environment in South Africa was uncertain; scores of retrenched employees used their packages to start businesses. But these businesses did not succeed due to poor management and skills.

Government, through its various entrepreneurship initiatives, has emerged as an important driver of change. Government programmes leading to skills development and encouraging entrepreneurship. These government interventions represent a change in the "transforming structures and processes", which has resulted in a positive feedback by changing the mindset of the human capital:

"...so in principle the change of mindset its like the beginning of everything, and you cannot be motivated if your mindset hasn't been changed to see things in a much different way or in a positive way" (AR).

One interviewee argued that government initiatives are failing since people's motivation for being there is survivalist as opposed to entrepreneurial, and they

don't have the business management skills or the entrepreneurial personalities to take advantage of these initiatives (AL).

The change in mindset could also be attributed to a lack of government action:

"People are not waiting so long for government. They are starting to realize that government is not going to deliver. These kids that have come out of school with no job opportunities and have started to think about that. There are more go-getters than maybe their parents were, or lots of new immigrants who by nature as I have indicated, are more entrepreneurial" (AP).

Individual capital is intrinsically linked to social capital. Social capital describes the interactions between individuals and their ability to act as a collective for individual and community gain. Any network is a function of the capability and capacity of the individuals within it.

The analysis of the individual system can be extended to an examination of basic human needs. Bossel (1999) relates the basic orientors to the nine basic psychological and social needs as described by the development economist Manfred Max-Neef as follows (corresponding basic needs given in brackets): Existence (Subsistence); Effectiveness (Understanding, Leisure); Freedom of Action (Freedom); Security (Protection); Adaptability (Creation); Coexistence (Participation); Psychological Needs (Affection, Identity).

6.3.4 Natural Capital

Natural capital did not appear as a feature of the informal market from the interviews conducted. Although natural capital would feature strongly for those whose livelihoods depend on resource-based activities, for example farming, fishing, mining, it still remains a survival element for everybody in terms of food provided and having a healthy environment to live in (DFID, 1999).

The conversation on informal markets was focussed on an urban environment, as opposed to a rural one. Therefore farming activities, even subsistence farming activities, were not considered. All the interviewees also do not live in areas where urban environmental problems have a direct and visible impact on people's lives.

Natural capital is maintained in the model, since the researcher is confident that communities that live close to tailings dams in Johannesburg, for example, who suffer detrimental health impacts as a result, would have a different view on the importance of natural capital to their lives. There is also a strong interaction between natural capital and human and social capital that cannot be ignored.

6.3.5 Physical Capital

Infrastructure was described as a critical element of growth in the informal economy. The cost of transport was identified as a critical element of business success, since it facilitates the transport of supplies to businesses and getting goods to market. However, infrastructure is not limited to just roads and water

and sanitation. It also includes the facilities and equipment that are required to function productively:

"It costs money to be in the informal sector. You have to take all your produce back home every day or you are threatened by thugs on the street, or your stuff gets stolen or the rain destroys it. There is a kind of cost to be in that kind of economy and if someone is to provide you with infrastructure support, would allow you to store your stuff, would allow you to get transport to the market more easily, reduce your banking charges so that you can SMS, you know, those kind of technologies I think can certainly provide a more thriving, healthy and active informal economy" (AP).

The lack of information was also identified by an interviewee as an impediment to growth (VS). The lack of adequate communication facilities, and the high cost of communication is a topical issue in South Africa, which has serious implications for development:

"The thing that interests me in South Africa is probably the shortage of general services that are available in the township environment. I would guess, I haven't been to Asia, but certainly compared to South America, you can pretty much get anything. Whereas here its all about mindsets and capital and all the things we have mentioned but, its pretty hard to send an e-mail in Alex, its really hard and for a reasonable price as well, and I mean you go there and no its down its broken, oh no the shop is closed, you know, and this such an essential tool that people need" (AP).

An observation by one interviewee was that as incomes increase, there is a tendency for people to improve their homes, by building or purchasing furniture, for example. This indicates an increase in physical capital that is a result of the feedback loop from people being able to achieve their livelihood outcomes, in this case, a greater income. An indicator identified to represent the health of the local economy can therefore be the type of dwellings in the community.

Infrastructure is an important enabler and often manifested on a physical level that allows for visual assessment. However, with technological advancement, infrastructure is increasingly invisible. Communication infrastructure is a critical element to strengthen social networks and develop individual assets. Communication allows the spread of knowledge, which can be very empowering for communities, and can have immense influences on all other system elements.

6.3.6 Financial Capital

The major source of financial capital in the informal market is the income earned from either formal or informal activities or both, from remittances, and from government grants. Common indicators are household income and personal disposable income:

“What partly funds the informal sector is money earned in the formal sector”

(AL).

"There is actually plenty of money coming in through wages that people are earning and grants. Government is spending lots of money there" (AP).

As a result, unemployment in the formal sector results in an increase in people running survivalist businesses to escape poverty. This underscores the critical interlinkages between the formal and informal economy, especially in terms of the transforming structures and processes, where policies, legislation and other institutional structures can have major effects, and unintended consequences, on the informal market. It also highlights the important role that government plays in advocating for greater job creation in the formal economy.

The lack of access to financial capital is seen as a major impediment to growth in the informal market. Indicators to access to capital could be number of mortgage bond originators or number of loan sharks. However, an increase could mean that people are in more debt for survival purposes, rather than for production (ED). The informal sector does access capital, through social networks and stokvels, but rarely through formal institutions:

"There is good access to capital but it is not formal" (ED).

There seems to be limited success of micro-finance institutions in the informal market:

"I think your micro finance institutions, from what I have heard, haven't worked. No one really gets money, they complain about corruption and I don't know myself from the numbers what is actually happening, but seeing the

hurdles they have to jump through and the interest that they charge, people don't get money from the banks and they don't get money from the micro finance institutions. I think these institutions have been bureaucratic government agencies rather than entrepreneurial you know, service institutions at the local level. You are making judgements on, okay I'm going to trust this person with R50 000 and I'm not going to trust this person" (AP).

Financial Capital represents the potential of the liquidity within the market. Financial capital is necessary in people's day to day lives, and the access to financial capital, as well as its transport, are well recognised needs. However, micro-finance institutions are failing to meet this need within the informal market. It is possible that they are missing certain key components to financial capital and how it relates to other elements of the model.

For example, using the basic orientors as a basis, we can imply that financial capital, firstly needs to be there (Existence), meaning that people need a means to earn money; that it needs to be safe (Security); that people need the freedom to use it for different and changing needs (Freedom), that it must serve their needs effectively since it is a scarce resource (Effectiveness); that it needs to coexist with other forms of assets and their use (Coexistence); and that it needs to be adaptable to changes in peoples lives (Adaptability).

6.3.7 Transforming Structures and Processes

The transforming structures and processes can be seen as the most important element of the model. It is the machine that allows the assets to be

transformed into livelihood outcomes based on the livelihood strategies chosen. The institutions and policies have a very significant impact on assets by creating assets (for example by investment in infrastructure), determine access to capital (for example, by ownership rights), and by influencing rates of asset accumulation (for example, by taxation) (DFID, 1999).

Government

Government structures play an important role in informal markets. Government programmes, like Khula for example, have provided management training and financial incentives to Small, Medium and Micro Enterprises (SMMEs) and have

*“ ..contributed quite significantly in terms of growth in the informal sector”
(AR).*

Government programmes have contributed to the increase of livelihood assets by increasing the financial and human capital in the community, and enabling people to meet their own needs more effectively. Government also has a role to play in protecting and maintaining the common goods, and even turning a blind eye in some cases when its own laws are being broken:

“there will be those very basic services, your refuse is being taken away so you will have a clean environment, health laws so you can buy from hygienically safe places... the fact that the government lets you trade a little bit onto the street, is a little bit loose..even though the government is not there to enforce

*its bylaws probably helps people to spill out a little bit and wheel and deal”
(AP).*

Private sector: Informal

Many indicators for the private sector emerged from the interviews. The question was directed at finding indicators of economic activity in the informal economy, and so has a bias towards private business enterprises. Entrepreneurship is central to the creation of a vibrant local economy and the indicators of economic activity listed below explore various facets of the local economy:

- New jobs created in informal enterprises.
- Number of people employed in informal enterprises.
- Turnover of commercial enterprises that interact with the community.
- Retail enterprises: number, type, turnover and credit terms given. The largest sector is the retail sector, and they are believed to move quickly to changing environments (ED).
- The number of informal enterprises: These can be categorised into survivalist enterprises and entrepreneurial enterprises. Survivalist businesses are not pursuing a business opportunity, but exist purely as a means to escape poverty. Survivalist businesses are usually those businesses that have lower barriers to entry (ED). Irrespective of

whether it is induced by positive or negative economic change, that is, an increase in survivalist activity or not, a visible increase in pavement activity is an indicator of economic activity (AP).

- Diversity of informal enterprises: Representing the diversity of commercial activity to meet different needs. As the community becomes more prosperous, a more diverse range of businesses are found, and more businesses that represent higher value products and services.
- The way in which businesses operate: whether they are moving up the value chain to gain more power and capture more of the value.
- Types of products being sold: Enterprises in poorer areas sell basic products like bread, maize meal, milk and sugar. As income increases, people's needs become more sophisticated and businesses begin stocking higher value products to meet these needs.
- How long have the businesses been operating: This points to the sustainability of the businesses, and their ability to adapt to changing environments and customer needs. However, business sustainability may not be affected by just survivalist motivations and poor business management skills, but could depend on the macro effects on the entire business sector, for example, in both the formal and the informal sector, textile businesses went out of business because of being unable to adapt

to environmental conditions, namely competitive pressures imposed by Chinese players (ED).

Private Sector: Formal

There are firm linkages between the formal and the informal economies, and these were evident in the interview responses. The following indicators for the formal economy were mentioned as possible indicators for the informal economy:

- New jobs created in the formal economy, since there is believed to be a spill over of labour from the formal to the informal economy.
- The ability to make basic financial transactions: Cost sensitivity, together with the ability to pay for things and to transfer money, are seen as the key drivers of the informal economy (ED).
- Increase in the supply of goods and services to informal enterprises.
- An increase in the supply of luxury goods.
- Turnover of formal commercial enterprises that interact with the community.
- Number of formal enterprises present in the community: The presence of formal enterprises indicates business confidence in a lucrative market. Also, in terms of consumer behaviour, people tend to spend more at formal businesses as their wealth increases.

- Type of formal enterprises: Although the presence of formal enterprises may indicate a vibrant informal market their success may not be an indicator that people are doing better, for example, the Lotto displacing people's funds from other needs, and therefore not indicating that people are better off (ED).

Laws

The levels of crime and the inefficiency of the policing structures to deal with crime are recognised as important impediments to the efficiency of informal markets. Regulations that govern the registration and 'formalisation' of businesses also denies people in the informal market from gaining access to livelihood assets, like financial assets, and being able to protect themselves from environmental conditions, for example, being able to attain insurance.

Policies

Policies often inform legislation, and provide a framework for the functioning of public sector organisations (DFID, 1999). A macro policy like Black Economic Empowerment could have the effect of absorbing skills and talent into the formal job environment, and thereby reducing the pool of talent available to pursue entrepreneurial activities (AP). On the other hand, the lack of government enforcement of certain policies and regulations can be of benefit to the informal market, for example by-laws on street trading. (AP)

Culture

Culture represents the norms and beliefs of society, for example, a consumerist culture will influence the type of buying decisions people make. Culture also determines people's attitudes and worldviews, and how they view themselves within a larger societal context. "Institutions are embedded in and develop out of the culture of communities" (DFID, 1999). It includes the recognition of power relations that give status to certain group of individuals based on age, gender, or class (DFID, 1999).

In South Africa, cultural lines would prevent people from engaging with the informal economy. For example, "suburban whites", and increasingly, "disconnected blacks", do not participate in the informal economy, even if there are benefits, because of culturally based fears and a lack of understanding. Even within the informal markets themselves, cultural differences result in different attitudes and entrepreneurial thinking:

"People come to Alex from rural areas, from Zimbabwe, from Mozambique,... I would bet if you measured immigrant numbers you would measure a higher level of economic activity, particularly around certain ethnic groups. It is the same with Zulus, the theory is that if a Zulu person comes from Natal, to Alex, they have got nothing there except their brother, and then they are already the most entrepreneurial person in Zululand because they have left. They are someone who is a go-getter, they are not happy with sitting on the farm, they want to make their dream come true in Joburg. So they come with an attitude

already, so percentage wise they are your entrepreneurs or your go-getters or you adventurers and they come to Alex and they look around and they say I've got no one and if I don't put some food on the table and I'm on my own here and I'm going to make it happen... So I think even among the same ethnic groups you will find different patterns of entrepreneurial activity based on whether people are immigrants but certainly certain ethnic groups have a some kind of whatever it is that they learn on their fathers' knee about [making] a buck and are more confident in entering that space" (AP).

Informal markets are not homogenous, and the cultural differences can have negative impacts:

"the people call themselves the bona fide, like we are the bona fide Alex people and I have been here for 5 generations but they, its often these authorities, Zulu's come here or Sothos come here, their real home is back there but they just here for 10 months to make money and then to take the money back to their families, they don't really care about the community, they litter, they dirty the place, you know, where as we, this is our home, at the same time these people fly or simply do better than local people" (AP).

"...my girlfriend has just written a ... story of the Somali community in the Cape, who have literally been killed. They are being horribly murdered, as a statement, because they come in, they have started informal businesses, they out compete the locals, they drop the prices and they do well. So people like them because they get lower prices and they get all kind of things that they

never had before that these people bring with their entrepreneurial flare but they impact negatively on the local businesses that aren't able to compete" (AP).

Transforming structures and processes can be seen as the 'machine', which consists of a complex interaction of many elements, like levers, pulleys, silicon chips, human operators and weather conditions, which work together to convert inputs into specific outputs.

6.3.8 Livelihood Strategies

Prahalad (2005) emphasises the importance of the poor gaining the dignity of attention and choice from products provided by the private sector. These products must be designed with the particular needs of that customer in mind.

The sustainable livelihoods approach integrates this thinking by providing a framework to understand the factors that lie behind people's choice of livelihood strategies and to reinforce the positive aspects that provide choice and flexibility in meeting their needs. "The expansion of choice and value is important because it provides people with opportunities for self-determination and the flexibility to adapt over time. It is most likely to be achieved by working to improve poor people's access to assets – the building blocks for livelihood strategies – and to make the structures and processes that 'transform' these into livelihood outcomes more responsive to their needs" (DFID,1999).

Cost is one of the most important drivers in this market (ED), not just from the consumers' perspective, but also from the sellers' point of view, where resources are limited to purchase stock, and decisions are driven by the limited availability of financial assets.

Consumer behaviour in the informal market, which describes how people make choices to achieve their goals, was discussed in the interviews. There are some products that people would buy from informal traders because they are usually not available from formal businesses, for example traditional medicines and certain home-made products. Others, like hair salons, vegetable sellers and dry cleaners, for example, are supported because of benefits like lower cost, convenience (businesses are in close proximity to their homes and they don't have to incur the transport cost to get there and they operate for longer hours), and there is a relationship developed between the shop owner and customer resulting in regular customers getting credit, and home deliveries (AR.)

Business behaviour is based on having limited resources:

"What happened recently is that, and that is not necessarily true for all areas, but larger areas, ..some of the producers and the wholesalers started supplying the small businesses with a delivery system. It's extremely successful. Previously the guy had to go to Pick 'n Pay or any of the other shops close to his spaza. [He would] have to pay for the transport cost. There are a few private groups, like Coca Cola, [that deliver to] the shops, especially on Fridays and Mondays. And what actually happened there is that all these transactions

are cash transactions... So initially they decided they are going to deliver on a Tuesday or Wednesday, and then again on a Friday, just before the weekend when the business are more active. [But] then they started establishing that the market for their product was declining. [They found] that the earlier in the week you deliver the better. Because these are cash sales, the other guys get [to the traders] before you do and then they pay all their cash out. So what you get now is a huge drive on Monday mornings to start delivering to the informal shops." (AL)

People will meet their basic needs in a way that suits their own priorities and values. There is a space in the township for formal business and shopping malls, which provide a shopping experience that also meets social and entertainment needs. At the same time, spaza shops will continue to serve other needs, like basic goods at a convenient time and location.

6.3.9 Livelihood Outcomes

People's standard of living, and the different elements of it, emerged as an element of the informal market (AR). As people achieve their livelihood outcomes, be it increased incomes, reduced vulnerability or improved wellbeing, not only do they tend to increase their own livelihood assets, but also create opportunities for others by increasing the size and scope of the market. For example, as people's incomes increase, they invest in home improvements, which in turn provide opportunities for others to provide services, like window

fitting, and brick making (VS), thus reinforcing the virtuous cycle of development.

6.4 A Framework for Indicator Selection

The theoretical framework presented in the previous section (Section 6.3) provides an understanding of the informal market by describing the various elements of the informal market and how they interact with each other. This framework can then form the basis for developing indicator sets that will describe the current state of the community, and track changes with time.

The indicators would examine each element, and aggregate them into a hierarchy of indicators, which could culminate into a single composite indicator, or be presented as an information system of indicators.

There are various systems at play within this framework. The total community can be viewed as a complete system, as it interacts with its external environment. Within this system there exist a number of subsystems. These have been identified as:

- ***The assets systems***, which in turn consists of the following subsystems: the human system, the social system, the physical system, the natural system, the financial system
- ***The transforming structures and processes system***, which consists of the government system and the private sector organisational system.

The processes can be incorporated into the analysis of how these structures work and interact with other elements.

The indicator hierarchy can therefore follow this hierarchy of systems, as illustrated in Figure 13.

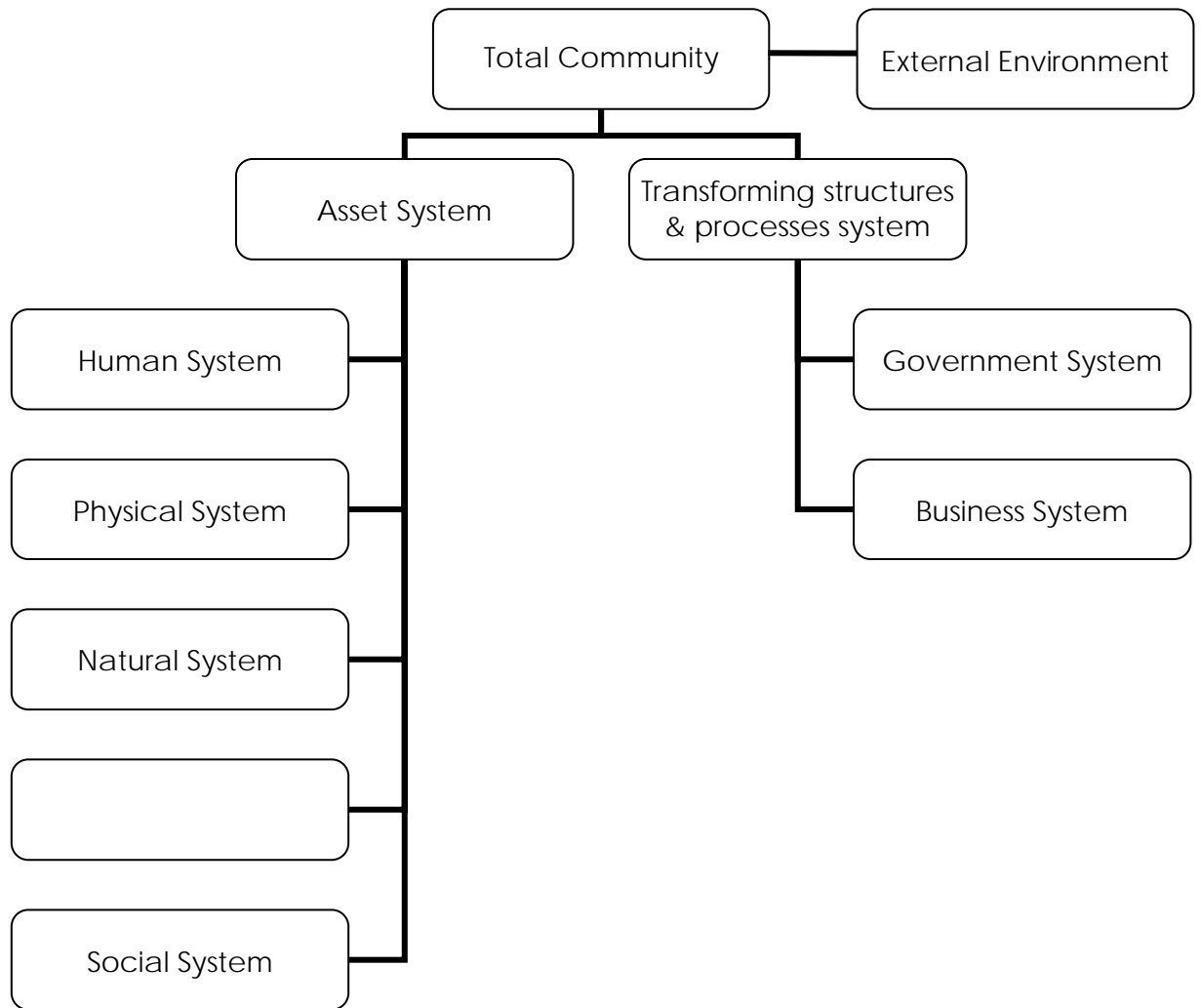


Figure 13. A hierarchy of indicators for the informal market

Each subsystem can be analysed as a system in itself, which is required to be viable within its own environment. Each subsystem must be viable for the total system to be viable.

A complete indicator set for an individual system can be generated by analysing each environmental stressor and basic orientor, and finding the indicators that would represent the state, and rate of change, of that element.

Bossel (1999) has identified the following leading questions for identifying indicators of viability. The same questions can be adapted to examine the impact of other systems on the system in question. The answers to these questions, and the justification for them, would point to specific indicators (Bossel, 1999):

- Existence: Is the system compatible with, and can it exist in its particular environment?
- Effectiveness: Is the system effective and efficient?
- Freedom of action: Does the system have the necessary freedom to respond and react as needed?
- Security: Is the system safe, secure and stable?
- Adaptability: Can it adapt to new challenges?
- Co-existence: Is it compatible with interacting subsystems?
- Psychological needs: Is it compatible with psychological needs and culture?

A detailed analysis will result in a large number of indicators. It is necessary to condense the indicator set as much as possible, without losing essential information. The following methods can be employed (Bossel, 1999):

- Aggregation into the highest system level.
- Condensation to the indicator of ultimate cause and ignoring the intermediate indicators.
- Applying the weakest-link approach, where only those indicators which pose the greatest threat to viability are considered.
- Basket average, which uses an index to combine a number of indicators describing various aspects of the same orientor.
- Basket minimum, which uses the worst performing indicator as a representative indicator.
- Representative indicator, which is one variable that provides reliable information about a characteristic of the whole complex system.
- Subjective viability assessment, which is a qualitative, subjective impression of the state of the system.

This provides a basic, high level framework on which to develop indicators for informal markets.

6.5 Conclusion

A model was proposed that combines the sustainable livelihoods framework with a systems approach. The framework is used to describe the various elements of the community as a market, and how these elements interact and are combined in particular ways to produce outputs that are compatible with the market's objectives. The systems approach introduces dynamism to the model and provides a framework for indicator selection.

The data has shown that the various elements of the livelihoods model can be applied to informal markets. Although the discussion does not cover all aspects of these systems, it does prove the applicability of this model to informal markets. A comprehensive analysis of each element can be done by examining its basic orientors. This analysis can then lead to the formation of indicators, which can be arranged into a hierarchy, depending on the level of detail required.

It is evident that the system is complex – it consists of a large number of elements that interact by the flow of information between them (Cilliers, 1998). These interactions are non linear, implying that a small exchanges can have large results; and they have a short range, usually through elements that are immediate neighbours (Cilliers, 1998). The flow of information also occurs through feedback loops, which can be positive (enhancing) or negative (inhibiting) (Cilliers, 1998). Complex systems are self organising and able to learn and adjust in response to the feedback they receive (Cilliers, 1998).

Systems cannot be controlled. They can be designed, but the end result cannot be predicted accurately. Learning about complex systems is therefore an iterative process of learning: intervening, receiving feedback, adjusting the intervention.

Meadows (2002) proposes that our interactions with systems should be like a dance with the system, where we “listen to what the system tells us, and discover how its properties and our values can work together to bring forth something much better than could ever be produced by our will alone” (Meadows, 2002, p2).

Dancing with the system begins with *getting the beat*. Meadows (2002) suggests that before disturbing the system in any way, to watch how it works and learn its history. Pay attention to the *wisdom of the system*, to the value of what is already there (Meadows, 2002). *Expose your mental models to the open air* by inviting them to be challenged (Meadows, 2002). *Stay humble* in the knowledge that your mental models will always be incomplete and that in the complexity of the world, there will always that which is unknown, and that which is unknowable.

Use indicator sets to allow you to *honour and protect information*, since it forms the basis of decision making. *Locate responsibility in the system*, since intrinsic responsibility within the system quickly sends feedback on the consequences of decision making (Meadows, 2002). *Policies should be flexible* around the feedback from the system.

When measuring the system using indicators, it is easy to pay attention to what is quantifiable. Meadows (2002) reminds us to *pay attention to what is important, not just what is quantifiable*. Many elements that are important can only be qualitatively described, like values. It is important to have a holistic perspective in working for the *good of the whole*, instead of maximising on only parts of the system (Meadows, 2002). When thinking about complex systems, think in terms of the *long term* sustainability of the whole system.

Expand your thought horizons beyond the traditional disciplines and “follow a system wherever it leads” (Meadows, 2002, p6). *Expand your boundary of caring*, since all parts are interconnected, and success in one area is not possible without success in others. Meadows (2002) invites us to *celebrate complexity*, its dynamism, and its messiness, and to *“hold fast to the goal of goodness.”*

CHAPTER 7 CONCLUSION

Informal markets are increasingly being viewed as lucrative opportunities for the private sector. An examination of informal markets cannot use the conventional approaches that are used in formal markets. All markets are complex by nature, but the degree of separation between the elements of informal markets and their related and supporting mechanisms, is much smaller. This implies that approaches to informal markets must be broader in their reach and more integrated across the various disciplines that relate to them.

The approach proposed in this report sees the convergence of conventional micro economics with development economics and the science of sustainable development. A community is used as the unit of analysis for the informal market. A model is proposed that uses the sustainable livelihoods framework to describe the various elements of the community as a system, and how these interact to produce desired outcomes.

A small sample of experts was interviewed to explore the informal economy from their own observation and experience. This process of exploration informed the search for a relevant theory base that could be applied to informal markets. The insights shared in the interviews pointed to the applicability of the proposed model to informal markets, and demonstrated the complexity of informal markets. Although the analysis presented is by no means

comprehensive, it does provide a systematic framework around which to formulate our ideas about informal markets.

This work was designed from the perspective of measuring the informal market. Measurement allows quantification and qualification of the phenomenon of the informal market and allows for more effective decision making. The conceptual model was therefore developed to gain a theoretical understanding of the phenomenon to be measured, and a high-level framework was presented for indicator development. It is considered to be the first, in a series of steps, towards developing indicators for the informal market, and even a single composite indicator for the informal market.

This exploration into characterising informal markets has opened up many opportunities for future research. This includes the analysis of each subsystem individually to understand its dynamics. Further there is a need to understand the various cause and effect relationships, to allow us to identify important levers within the system. Then, the formulation of indicators provides another avenue of further research, aimed at either developing a single composite indicator, or a hierarchical information system of indicators.

Complex systems force us to question our current worldview. They challenge our strongly held paradigms. They lead us onto a road of discovery that is noisy and bumpy and always unpredictable. Exciting, isn't it?

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APPENDIX A: HOUSEHOLD PROFILES

(Financial Diaries, 2006)



HOUSEHOLD PROFILES

* Names have been changed to protect the identity of the respondent.

PROFILE 1: The Rural Grant Recipient

Madlamini* is a 65 year old woman who lives with her two daughters, a nephew and four grandchildren. They all live on Madlamini's old age grant of R740 per month and in July and October, respectively, child grants of R170 per month for each of her two of the grandchildren commenced. Sometimes her daughter gives her money or food or net wire for the garden, but Madlamini says that it's not enough.

Her biggest concern has been to meet the payments of her one funeral plan and two burial societies. The first is with an undertaker, who comes to her house to

collect R5 per month. Another is only payable when someone dies, but there have been many funerals lately. The last burial society is paid R10 per month but they charge R20 if a payment is missed. She worries about missing a payment so she borrows to cover the cost of the burial societies. Over the study year, she borrowed six times from stokvels, seven times from mashonisas, 13 times from relatives and neighbours and taken credit at two of the local spaza shops. She has also taken various items – chicks, a wardrobe – on credit from 11 different private sellers. But she's also lent out money twice to relatives and neighbours (see Providing financial services in table below).²

PROFILE 1: BASIC HOUSEHOLD INFORMATION

Number of adults	3
Number of children	5
Average Monthly Gross Income	R 1070
Average Monthly Gross Income per member	R 118

NUMBER OF FINANCIAL INSTRUMENTS

Total	46
Transaction accounts ³	0
Insurance	3
Savings	2
Credit	39
Providing financial services	2

"I noticed that some people who don't have burial societies struggle to find money for the funeral. My child was sick, then my husband left me and then I thought the best thing was to join a burial society."

²Read more about Madlamini in Focus Note: Debt and Household Finance.

³As discussed in Focus Note: Savings and the poor – How do households accumulate lump sums?, households use savings accounts more as transaction accounts than savings. Therefore, savings accounts are listed as Transaction accounts.

PROFILE 2: The Thriving Rural Teacher

Joseph* is a 33 year old man who lives with his 31 year old wife, 2 year old daughter and new born child. The child was born just before we finished the study. This is a family that is doing well. Joseph earns about R9500 a month as a teacher. He pays a provident fund, four funeral plans and a retirement annuity via payroll deduction. His latest payslip also shows a deduction of R63 for an Old Mutual Group scheme but he's not sure what this is. He also pays R146 each month for an additional Avbob funeral plan via debit order and he has another retirement annuity with Old Mutual that will pay out in fifteen years. One of his major expenses is monthly child support of R200 each that he pays to three different women.

Another big expense is a house they are building next door, towards which they've already spent R40,000. Most of the materials were bought on credit from local shops and then paid off. He belongs to three stokvels and acts as a money guard for one of them using his Post Bank account. One is a savings group which pays out in groceries at the end of the year and another pays out on the member's birthday. He was paid out R2200 from this one in January, a large portion of which he put towards the house. During the year, he lent several times to his cousin.

PROFILE 2: BASIC HOUSEHOLD INFORMATION

Number of adults	2
Number of children	2
Average Monthly Gross Income	R 9300
Average Monthly Gross Income per member	R 2325

NUMBER OF FINANCIAL INSTRUMENTS

Total	29
Transaction accounts	2
Insurance	7
Savings	6
Credit	10
Providing financial services	4

"The thing I think about and plan for the most is to finish building the house and furnishing it."





PROFILE 3: The Urban Entrepreneur

James* is a strong quiet man who runs a very successful chicken and egg business. Despite his illiteracy, he is a confident and savvy businessman. He tends to earn about R2000 profit from his business per month. He opened the business after he was retrenched in 1999 from a job as a driver. He has learned how to make the business work well since then. For example, when he started the business, he gave credit to customers, but he now holds a strict rule of no credit because he found he wasn't being paid. However, although his business is going well, he was still interested in taking up a temporary painting job during the year. This income helped him to buy a car (although it doesn't run).

He and his wife have successfully managed to raise and educate three children and they own a home in the Eastern Cape. Nonetheless, he, like many in the shack settlement area, was determined to own a home and he moved into an RDP house during the year, without having it officially allocated to him. By the end of the study, he and his wife were comfortably established in this home, with no protest from the council. Despite these urban ambitions, the couple are still firmly based in tradition. His wife used to work as an office cleaner but is now studying to become a sangoma.

PROFILE 3: BASIC HOUSEHOLD INFORMATION

Number of adults	2
Number of children	1
Average Monthly Gross Income	R 4030
Average Monthly Gross Income per member	R 1340

NUMBER OF FINANCIAL INSTRUMENTS

Total	20
Transaction accounts	5
Insurance	3
Savings	3
Credit	5
Providing financial services	4

"As a businessman, every day I think about managing my money. It needs a lot of thought as I am very busy. People are buying my eggs and chickens so it's a good idea to take care of the money."

PROFILE 4: The Struggling Sheep Intestine Seller

Mambongo* is an illiterate 50 year old woman living in one of Langa's most crowded hostel areas, with her three children and grandchild. Their sole income is her profit from her business frying and selling sheep intestines in front of the hostels. She does reasonably well with her business – earning about R800–R1000 per month, with which she supports her household. However, business is often cash-tight and Mambongo needs to think of interesting ways to manage her cash flow. One way is through a rotating stokvel which she formed with three other sheep intestine sellers. Her daughters also use stokvels, sometimes contributing just R1 per day to build up collective savings towards Christmas.

When business does not go well, Mambongo needs to borrow from mashonisas to buy stock. She borrows about R50–R100 and pays off the debt at 30% per month. During the year, Mambongo was able to work for the council for about ten weeks as a street cleaner. She gladly took this job and left the running of the business to her daughter. Mambongo is a brave and rugged woman, but her business is risky and she struggles to make ends meet.

PROFILE 4: BASIC HOUSEHOLD INFORMATION

Number of adults	2
Number of children	3
Average Monthly Gross Income	R 1600
Average Monthly Gross Income per member	R 320

NUMBER OF FINANCIAL INSTRUMENTS

Total	19
Transaction accounts	0
Insurance	0
Savings	9
Credit	9
Providing financial services	1

"You need to look around and find a good umgalelo(stokvel). (In my umgalelo), we come from the same village and I am in an umgalelo with people I know."





PROFILE 5: The Moneylender

Sylvia* isn't a moneylender by profession – she's a domestic worker who works two jobs and lives in a shack. However, through her stokvel, she takes money and lends it out to neighbours. She's been very diligent and organised in doing this, but her investment did not pay off as expected. All year, she borrowed money from the stokvel and lent it out to friends and neighbours for a monthly interest fee of 30%. The table below shows this as "Providing financial services". Towards the end of the year, she needed to lean on these borrowers to return her money, and she ended up paying some of the loans out of her own pocket. However, she managed to make her full contribution to the stokvel and was expecting to be paid out R2600 in early December. But, just before we finished the study, we heard that the treasurer of the stokvel was shot and killed as she was returning from

the bank with the stokvel money for the members. She was carrying half the stokvel payout money and all of it was stolen. The members believe it was an "inside job" – someone who knew about the payout arrangements organised the robbery.

Aside from this method of savings, Sylvia also belongs to four other stokvels, has an education plan for her daughter, a fixed deposit account, two other bank accounts and saves money in the house. She is a diligent financial manager and is one of the few respondents who manage to put aside money in the bank and the house from her monthly wages.⁴

PROFILE 5: BASIC HOUSEHOLD INFORMATION

Number of adults	1
Number of children	1
Average Monthly Gross Income	R 2900
Average Monthly Gross Income per member	R 1450

NUMBER OF FINANCIAL INSTRUMENTS

Total	61
Transaction accounts	5
Insurance	2
Savings	9
Credit	5
Providing financial services	40

"Is the stokvel better than the bank? I think it is the same because just like the bank you have to commit yourself."

⁴Read more about Sylvia in Focus Note: Savings and the poor – How do households accumulate lump sums?

PROFILE 6: The Single Mother with Changed Circumstances

Nandiswa* is a young mother who lives in a squatter settlement in Langa with her mother and two children. She was once an avid science student and earned very good money as a nanny abroad. However, her family's dramatic change in circumstances came about when she needed to come home to have a child. She became worried about leaving her mother with her two children with so many fires happening in the settlement. (Just after the study was completed, a huge fire swept the settlement, displacing many households). The family spent over a year living off Nandiswa's savings from her earnings abroad, which she kept in a fixed deposit account (she had acquired some R14000 in 2002, but only R1000 was left when we started interviewing her). She managed their money very carefully, relying on two child grants and contributions from her child's father. She believed strongly in using the bank rather than savings clubs to manage her money. Because her work circumstances

changed so dramatically, Nandiswa knew that she needed discipline to keep from spending too much. She often commented that she was pleased that her savings account was so inaccessible, as it would keep them from spending the money. She also said that this prevented her from lending it out to neighbours when they asked, although she couldn't say no all the time! (See table below – Providing financial services was seven separate loans to neighbours.)

By October, both Nandiswa and her mother had found full time jobs and she welcomed a rural cousin into her home to care for the children. However, although she would like to move out of the squatter settlement, she is still very cautious about the future and she wants to build up her savings again before they move.

PROFILE 6: BASIC HOUSEHOLD INFORMATION

Number of adults	2
Number of children	2
Average Monthly Gross Income	R 2500
Average Monthly Gross Income per member	R 625

NUMBER OF FINANCIAL INSTRUMENTS

Total	23
Transaction accounts	3
Insurance	1
Savings	1
Credit	11
Providing financial services	7

"The bank is the best way (to save) as it doesn't tell you stories when you need your money. People tend to do this when you need your money."

