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Mainstreaming Willingness among Black Owned Informal SMMEs in South Africa

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Abstract
South Africa is faced by a growing informal economy with black entrepreneurs constituting the majority. The government has spent large budgets but the size of informal black entrepreneurs remains significantly high. The objective of this paper is to understand the factors behind the formalisation willingness of South African black owned SMMEs. The conversion rate of informal businesses into the formal economy is insignificant considering the potential carried by small businesses in championing the inclusive and sustainable economic growth objective especially when they are formalised. Cross-sectional data was collected using a questionnaire from 390 in Johannesburg and Pretoria using stratified random sampling and clustered sampling. This study employed a multinomial logistic regression. The study found government support, corruption, employment compensation, family labour, success perception, education status, age and financing as key drivers on willingness of SMMEs to formalize their operations. The implications of our findings warrant the government to foster more financial supporting pillars to match up huge volumes of informal business that lack funding opportunities. Institutions of higher learning should also take the initiative of having incubation centres and innovation hubs to facilitate capacity building as that can cultivate willingness to mainstream. The purpose of the study was to find determining factors of positive willingness to mainstream and it very significant as it specifically target black entrepreneurs who are highly concentrated in the informal sector. Finding factors that instigate positive willingness impact on improved graduation rates of SMMEs and that also impact on improved success rate of small business in the country. Improved success rate of small business has positive effects on employment and economic growth.

Keywords: Mainstreaming; Transition; Informal; Multinomial Logit; Willingness

INTRODUCTION

The objective of this paper was to understand the driving forces of black informal small micro and medium enterprises (SMMEs) in South Africa to changeover into the formal sector. South Africa has been struggling to find its way towards creating sufficient and shared growth to create jobs for the poor. Economic growth has disappointed in South Africa failing to impress above 2% whilst unemployment has been surging on a yearly basis and it currently stands at 29% (Statistics South Africa 2019). The episodes of slow, disappointing and unsustainable economic growth coupled with rising unemployment in South Africa has made it inevitable for SMMEs to act as one of the most important pillarsto the economy on spurring economic growth and job creation. However, the huge numbers and slow pace of SMMEs mainstreaming their businesses continue to drag those goals, hence the purpose of this research was to investigate what motivates informal SMMEs to formalise.

However, in as much as SMMEs have appeared to be an important institution in South Africa in solving socio-economic problems like poverty and unemployment, there are still over one and a half million small businesses that are still operating informally. The International Labour Organisation (ILO) advocates for sustainable and decent jobs but those cannot be realized whilst workers are informally employed. On the other side, these SMMEs for them to contribute significantly to economic growth and job creation, they have to be operating formally where they can start to contribute to the tax base of the country whilst creating sustainable livelihoods for the owners together with the workers (ILO 1973). Levy (2008) iterates that a country with a huge informal sector lacks development and is less able to fund its public service because of a low tax base. Benjamin et al., (2014) argue that informal business pose unfair business competition to formal business and that might have a crowding out effect of formalized businesses who might feel threatened by informal business. This is especially when the same commodity is also being sold on the street at a cheaper price mainly because informal businesses do not pay rent, do not pay standardized wages and do not pay tax.

Arguing on the mainstreaming of informal SMMEs, Fajnzylber et al., (2011) found that in the case of Brazil, formalisation has an effect of increasing success by 40-50% whilst having a significant impact on profits and government revenue. In the case of Vietnam, Rand and Torm (2012) posits that for the SMMEs that formalized in the period 2007-2009, there is evidence that their investments as well as their profits increased. However, in as much as there can be plenty of benefits that are associated with formalising operations, it remains with business owners depending on their perceived cost benefit analysis on mainstreaming. The main objective of government and various stakeholders that assist SMMEs is to see informal small businesses become successful and then graduate into the mainstream economy so that they can start to contribute to tax and national output. However, in South Africa the number of informal businesses surviving beyond 3 and half years and finally progressing to the formal economy has not been as per the expectations.The ratio of the small businesses operating in the formal economy (667 433) vis a vis those still operating in the informal economy (1 497 860) (GEM 2014). The conversion rate of informal businesses into the formal economy is still worrisome considering the potential carried by small businesses in championing the inclusive and sustainable economic growth objective hence this research seek to solve that problem by understand the determining factors for willingness to formalise businesses.

In this paper, a business is regarded “informal” if not registered in the database of the company registration office in South Africa. The definition for informal business that is used in this paper is in line with the definition used by De Soto (1989). Our definition includes business that operate in public spaces and those that are not involved in illegal goods or drugs as argued by other scholars such as Renooy (2000). Renooy argues that being informal might as well mean that businesses are engaging in illegal activities giving reasons why firms are operating undercover. So legally the businesses are not recognized, do not pay tax and they do not confirm any character of legality but they are not involved in trading of illegal goods as argued by (Chen 2006).

The importance and relevance of this study come from the background that the informal sector has become a source of livelihood for millions in South Africa (jobs and income). The concept of mainstreaming informal businesses is at the centre of economic development debate in Africa as countries strive to regain their path to sustainable economic growth and poverty reduction. South Africa is not spared since 50% of the population has been declared poor, 26.7 % of its people are not employed and close to 60% of its youths are not employed (Stats SA 2017). Coming up with policy options SMMEs mainstreaming is of paramount importance to the development path of South Africa especially those that are owned by black entrepreneurs, hence a research gap this research attempts to cover. Formalisation might lead to increased government revenue, increased productivity, creation of sustainable and decent jobs and a positive economic growth pattern. This paper tested if SMMEs with better educated owners, received government assistance have positive success perception stand better changes of mainstreaming their businesses compared to the contrary and that makes the work new especially modeling success perception of entrepreneurs linking it to their willingness to mainstream.

To cover the knowledge gap, the current research quantified a qualitative variable to measure mainstreaming willingness. The paper models a qualitative variable (willingness) using a quantitative method (multinomial logistic regression) with a bigger sample size of 390 SMMEs. This variable is important because it captures the self -driving factors within different entrepreneurs. To the best of our knowledge we have not identified a single research in South Africa that has used that variable to investigate what instigates SMMEs to mainstream. Also our research targeted only indigenous black South Africans who run businesses in the informal sector, a gap that has not been filled in the country’s literature especially on small business formalisation willingness. The reasons to target only black South Africans were based on the fact that they form the biggest percentage of informal businesses in the research area that have the highest failure rates and also that black South Africans have the highest poverty rate across all the other races in the country (Statistics South Africa 2017). The argument being that if the bigger percentage of black businesses formalise, that broadens the tax base of the country, can increase the number of sustainable jobs in the country at the same time improving profits of their businesses leading to a reduction in poverty rates amongst black South Africans.

Research Objective

- To find the mainstreaming determining factors among black informal business in South Africa

Research Question

- What are the socio-economic factors that determine the mainstreaming of black informal businesses in South Africa?

The rest of paper is divided into literature review, methodology and data collection issues, discussion of the research findings and lastly conclusion and policy recommendations.

LITERATURE REVIEW

Informal SMMEs play a pivotal role in most developing countries across the globe, and this is mostly because of their volume. They do not only provide jobs for millions of people but in fact they also play a role in supplying varied products and services that are sometimes not offered or under offered by formalized businesses (Rootman and Kruger 2010) .Whilst acknowledging the importance of informal SMMEs on job creation and service provision, for all stakeholders in the economy to benefit, these businesses should be helped to formalise their operations. Formalised businesses contribute to national coffers, they offer decent jobs, they have better chances of securing credit and they are also argued to enjoy better profits compared to those that operate informally (ILO 2014; Monteiro and Assuncao 2012).

The building blocks of theories that inform the transition or formalisation of businesses that operate in the informal sector are at least grounded on three schools of thought which are, the legalist school by De Soto (1989), the structualist school by Portes et al (1989) and dualist school argued by the International Labour Organisation (ILO) in 1972 (ILO 1973).

Firstly, this paper will start by discussing the legalist school of thought which argues that firms choose to operate informally because they want to avoid getting taxed and operating under watch from the government rules and regulations (De Soto 1989). The legalist school labels the activities that happen outside the government regulations as the shadow economy. This is despite the fact that the trading that informal sector players are done in public space and most of them are not involved in illegal goods. Also there has been arguments that there is a link between the informal economy and the formal sector and the informal sector players already pay Value Added Tax (VAT) when they procure their wares from the formal sector. De Soto (1989) also argues that some of the businesses that operate in the informal economy are as a result of governments' red tape in processing the registrations of businesses. The legalist school also mentions the long queues that business people have to endure in order to register their businesses or pay taxes (Devey et al., 2006). Arguing for the transition of businesses from operating informally the legalist school advocates that governments should deal with red tape and create situations that cut costs of registering and processing taxes so that more businesses can be encouraged to join the formal sector.

Secondly, the dualist school of thought by ILO in 1972 departs from the legalist school on the sense that it views the participation of businesses in the informal economy as a choice of last resort (ILO 1973). It argues that people choose to work in the informal sector because they are not competent enough to find jobs in the formal sector. This school of thought views the informal sector as a hive of incompetent people who are less educated and less skilled. So, the activities that happen in the informal economy are argued to be separate activities that are not linked from the formal sector. However, the dualist school of thought might have overlooked the fact that informal sector players procure their inputs or their wares from formal sector businesses hence it won't be correct to argue that there is no linkage between the informal sector and the formal sector. It will be also wrong to argue that the informal sector and the formal sector are two distinct sectors with no linkage or relationship but the only difference between these is that the other pay all taxes whilst the other one does not. The other one is registered and has higher chances of accessing credit and make bigger profits but the other one has less chances of such benefits (Menya 2009). In South Africa, graduate unemployment is averaging 7% of total unemployment (Statistics South Africa 2018). That statistic informs us that the informal sector becomes a safety net for those graduates who cannot secure employment and some of them can actually come to a point of creating their own jobs but because they lack capital or it is costly to formalise in the short run, they may choose to operate informally. The view of this paper is that, the persistence of informal sector activities is exacerbated by low economic growth patterns experienced by the South African economy failing to absorb more job seekers into the labour market and also the rigidity of the system on simplifying formalisation.

Lastly, the structuralist school by Portes at al., (1989) views the informal economy as a subordinate of the formal economy. In that context, the informal economy serves to reduce the input costs of production for large formal businesses. The informal economy feeds informal labour to formalised businesses who seek to cut down costs of labour so as to maximize their profits. For example, a formalised company might choose not to employ permanent workers to offload and do the packaging but employ people as and when they are needed and these people will not be having any formalised contract of employment with the company. Devey et al., (2006) argue that the growth of profits of formalised businesses depends of the size of the informal sector. The more the people are willing to work in the informal sector the more the profits the formalised businesses make. Janneke et al., (2011) communicates that the formal businesses subcontract the most labour intensive stage of production to the informal economy and save on labour costs. So, the Structualist School suggests that there are two separate structures of the economy forming a link where both structures benefit from each other.

The meeting point of the three schools of thought that attempt to explain the informal economy rests on the fact that they all agree that the informal economy is inferior compared to the formal economy. The Structualist approach actually identifies the informal economy as a subordinate sector to the formal economy where there are less skills that can be exploited by formal firms to save costs and push high profits. This is exactly what the dualist school also perceives about the informal economy. The dualist school of thought views the informal economy as a sector that accommodates only less skilled people who are only looking for survival. This then means that the dualist school identifies the informal economy as a survivalist hub. According to the ILO (1973), workers who participate in the informal sector can only escape poverty if the businesses they are working for mainstream or transit into the formal economy. Finally the legalist school agrees with the dualist and structualist on identifying the informal sector based on the perspective that the informal sector as a sector for criminals who avoids rules and regulation. It argues that the people who participate in the informal economy are mostly tax evaders and those that are frustrated by government's red tape. All these schools agrees on the fact that society will be better if there is more formalised firms than those that are informal since that will increase government revenue, increase success rate of small businesses as well as the provision of decent jobs to employees.

METHODOLOGY AND DATA ISSUES

Sampling and Sample Size Selection

Gauteng province is an area which is multilingual but there are three majority languages which are Tswana, Zulu and English. The questionnaires used translated from English to the other 2 indigenous languages so that those who do not understand English could understand the questionnaire and those who could not read were read out the questionnaire in the language they understood and their responses were captured by the research team. The questionnaire went through a pilot phase and after comments were received from the pilot study, the final questionnaire was then used for the main data collection. Also the research was awarded an ethical clearance certificate by the University of Zululand research ethics committee. After data was analysed, the researcher went to a sample of SMMEs that were involved with the findings to show the business owners if the findings were a true representation of information provided. The majority of the informal businesses that were visited were identified that they operate in clusters. Given that fact, clustered random sampling technique was used so that SMMEs in all the clusters get equal probability of being interviewed (Cresswell 2014). The economic activities that were considered in this research are manufacturing, wholesale and retail, transport and lastly other services. Questionnaires were handed out depending on the size of each and every economic activity involved in this study as publicized by GCRO. That background led us to distribute 31% of the total questionnaires to manufacturing, 26% to wholesale and retail, 25% to transport sector and 18% to others services. Gauteng province has an estimated number of close to 700 000 informal SMMEs and 550 100 SMMEs that are operating formally complying with all the rules that guide businesses in the country. In choosing our sample size, the study borrows adopted from Alvi (2016) and Stattrekcom (2016). In an area with 700 000 SMMEs, the formula calculates 385 as the appropriate sample of these SMMEs.

Variable Description and Measurement

Willingness – The dependent variable. It measures the willingness of SMME owners to formalize. Its coded as (1) very soon (2) not decided (3) not anytime soon.

Government support –(1) if the SMME owner has received government assistance before. (0) if otherwise .

Formalisation knowledge–(1) if the SMME owner knows all the processes of formalisation in South Africa. (O) if otherwise .

Financial inclusion –(1) if the SMME has ever received credit from a financial institution. (0) if otherwise .

Business age – the number of years the SMME has been operating.

Success perception – It measures how the SMME owner perceive about own success in business. (1) if the owner feels successful and (0) if otherwise.

Family labour – it measures the extent of family members who are working for the business. (1) if all them (2) if some of them (3) if none of them.

Sector- it simply identifies the sector in which the SMME is operating in. (1) Manufacturing (2) Wholesale and retail (3) transport and (4) other services.

Reason – this variable was identifying the reasons for the SMME to be operating in the informal sector. (1) own choice (2) cost full to formalize (3) other.

Age – identifying how old the business owner is . It is a continuous variable

Corruption- Measured if the SMME has ever paid a bribe to a government official. (1) always (2) sometimes (3) never.

Education – this variable was identifying the highest education attained by the business owner. (1) primary (2) secondary/matric (3) tertiary (4) other.

Model Specification

This paper shall employ a multinomial logit model (MLM) mainly because of the nature of the dependent variable that we have in our model which is trichotomous in nature. The model is adapted from the work of Powers and Yu Xie (2008). Our data consists of 390 informal SMMEs who were responding to three categories of their willingness to formalize their operations: very soon, not yet decided and not anytime soon, the options were coded as 1, 2 and 3 respectively. The choice of SMMEs owners for each category given above depends on a list of variables that they also responded to in the questionnaire. We assume that SMMEs choose the alternative based on the availability of benefits or their business situation in the market. For example If someone is making good profits, owns properties and is paying employees every time, we expect that SMME owner to want to formalize as soon as possible holding other things constant. To further illustrate, let

$Y_{ij} = 1$, if the SMME i chooses alternative j ($j = 1{,}2$ and 3in the case we have)

= 0, otherwise

Further, let

$$\pi_{ij} = \Pr\,(Y_{ij} = 1) \qquad (1)$$

In the above expression, Pr represents probability.

Therefore, $\pi_{i1}, \pi_{i2}, \pi_{i3}$ represent all the probabilities an individual SMME chooses alternative 1, 2, or 3 respectively. Those are very soon, not decided and not anytime soon. Since the options are mutually exclusive probabilities and also since these are the only alternatives an SMME has then it must be obvious that;

$$\pi_{i1} + \pi_{i2} + \pi_{i3} = 1 \qquad (2)$$

Multinomial logit model expressed below;

$$\pi_{ij} = \frac{e^{\alpha_j + \beta_j X_i}}{\sum_{j=1}^{3} e^{\alpha_j + \beta_j X_i}} \qquad (3)$$

X – represent all the explanatory variables that help to determine the choices

β- represent vector of coefficients in the model. The number of slope coefficients will equal the number of variables in the model.

In our basic MLM there is subscript j both on the intercept and the slope coefficient as a claim that these coefficients can be different from one choice to the other. This mean that an SMME that chose "very soon" attaches a different weigh to each explanatory variable than those who are not yet decided or those that chose not anytime soon. This also applies to other two choices.

The three probabilities estimated from equation (3) may produce different coefficients for the given regressors. Since our dependent variable has three choices, this means that when we estimate the MLM, we will be estimating three regressions at once. This is so because under MLM we cannot estimate these equations independently. When estimating an MLM, one category or choice has to be chosen as the base or comparison category. This means that the outcomes of the other two categories will be interpreted basing on the other category used as the base category. The coefficient of the base category will be set as zero so that a comparison can be done.

For example if we choose the first category (yes very soon) as the base category and set $\alpha_1 = 0$ and$\beta_1 = 0$, we get estimates of the probabilities for the three categories like the one shown below;

$$\pi_{i1} = \frac{1}{1+e^{\alpha_2+\beta_2 X_i} + e^{\alpha_3+\beta_3 X_i}} \qquad (4)$$

$$\pi_{i2} = \frac{e^{\alpha_2+\beta_2 X_i}}{1+e^{\alpha_2+\beta_2 X_i} + e^{\alpha_3+\beta_3 X_i}} \qquad (5)$$

$$\pi_{i3} = \frac{e^{\alpha_3+\beta_3 X_i}}{1+e^{\alpha_2+\beta_2 X_i} + e^{\alpha_3+\beta_3 X_i}} \qquad (6)$$

In equations 4, 5 and 6, we notice that, although same regressors appear in each response probability expression, their coefficients will not necessarily be the same (Powers and Yu Xie 2008). Also if we add the three probabilities that are given in equation 4, 5 and 6, we will get a value of 1. That is so because we have three mutually exclusive choices. Also of note is that the probability expressions that are given in equations 4, 5 and 6 are highly nonlinear. Let us now consider the following expressions:

$$\ln\left(\left(\frac{\pi_{i2}}{\pi_{i1}}\right) = \alpha_2 + \beta_2 X_i \qquad (7)\right.$$

$$\ln\left(\left(\frac{\pi_{i3}}{\pi_{i1}}\right) = \alpha_3 + \beta_3 X_i \qquad (8)\right.$$

$$\pi_{i1} = 1 - \pi_{i2} - \pi_{i3} \qquad (9)$$

Equation 7 and 8 are built from the basic logit models and here they are simply the linear functions of the explanatory variables. They can also be explained as logs of the odds ratio (logits). The odds tell us by how much alternative 1 is preferred over alternative 2. So our link function in the multinomial logit model (MLM) is the logit. Equations 7 and 8 cannot be estimated separately or independently simply because standard errors are very small when they are estimated together as opposed to them being estimated separately (Long and Freese 2008). Also individual estimation of the logits will not guarantee us that the three estimated probabilities will add up to one as they are supposed to do. So because of the stated reasons above, equation 7 and 8 must be estimated simultaneously by the maximum likelihood.

RESULTS DISCUSSION AND ANALYSIS

Multinomial logit model (MLM) output

Our findings from the multinomial logistic regression will be interpreted against the base category (yes very soon) to analyse factors that determine the willingness to formalize. The sample of SMMEs interviewed was strictly black owned SMMEs that operate in the informal sector of the Johannesburg/Pretoria area in South Africa. Only significant variables will be reported and the other results are annexed at the back of this paper. The first panel of table 1 below gives the values of various coefficients of category 2 (Not yet decided) against the base category. It gives the estimates of the logit (equation 7). The second panel of the table gives similar information for willingness category 3 (Not anytime soon) in relation to category 1 (Yes Very soon). Panel 2 shows the estimates of equation 8.

In panel 1 education level (edu), Familily labour (famlab), sector of operation (sect), success perception (succperc), financial inclusion (finincl), formalisation effort (formeff), corruption (corr) and employee compensation (emplcomp) are the variables that are statistically significant. In Panel 2 success perception (succperc), financial inclusion (finincl), government support (govtsupport), corruption (corr) and employment compensation (emplcomp) are statistically significant.

Table 4: Interpreting logs of the odds (logits)

Multinomial logistic regression

Number of obs=328

LR Chi2 (33) = 157.12

Prob > chi2 = 0.0000

Log likelihood= -279.47178

Pseudo R2 = 0.2194

Willingness	Coef	Std. Err	z	P>I z I	[95% Conf. Interval]	
Not yet decided						
Edu	.7193	.2689	2.68	0.007***	.1923	1.2462
Famlab	-.4114	.2257	-1.82	0.068*	-.8539	.0310
Sect	.3396	.1751	1.94	0.052**	-.0036	.6828
Succperc	-1.33591	.4128	-3.29	0.001***	-2.1683	-.5499
Finincl	-1.0463	.3203	-3.27	0.001***	-1.6741	-.4184
Formeff	-.7689	.3672	-2.09	0.036**	-1.4886	-.0491
Corr	-.5960	.2766	-2.15	0.031**	-1.1382	-.0539
Emplcomp	1.0736	.3871	2.77	0.006**	.3148	1.8322
_cons	.6065	1.0942	0.55	0.579	-1.5381	2.7511
Not anytime soon						
Succperc	-1.5540	.3686	-4.22	0.000***	-2.2764	-.8316
Finincl	-.6504	.2774	-2.35	0.019**	-1.1942	-.1068
Govtsupport	-1.2180	.3406	-3.58	0.000***	-1.8855	-.5506
Corr	-.5134	.2353	-2.18	0.029**	.9746	-.0523
Emplocomp	.9514	.3326	2.86	0.004***	.2996	1.6033
_cons	3.0906	.9328	3.31	0.001	1.2622	4.9189

(Yes very soon==1 is the base outcome)

Source: MLM regression results (Author)

Note the conventional significance leves are: (10% (0.1*); 5%(0.05**) and 1% (0.01***)

Panel 1

When we interpret odds, a positive value of a coefficient of a regressor indicates increased odds for one choice over the base category/choice. Likewise, a negative value of a coefficient gives an implication that odds in favor the base category is greater than the other category for example, not decided or not anytime soon. Thus, referring to table 1 which has the findings of our paper, we observe that if education level increases,

more SMME owners will remain undecided whether to join the formal sector as soon as possible or to stay informalised, holding all other things constant.

However, we would have expected the increase in education to have more impact on formalisation knowledge, hence encourage SMMEs to made decisions that are positive towards formalisation. We also assume that educated people do cost benefit analyses hence there are no clear benefits to formalisation in South Africa. On a different note, it was found that there is a negative relationship between family labour and the base category (yes very soon). This implies that the less family labour is involved in business the more SMMEs make decisions to formalize. Businesses that are involved with more family members working for the business are more likely to remain informalised compared to those with less family members. SMMEs that have capacity to employ employees that are not family members are considered successful hence stand high chances to formalize their operations (World Bank, 2013). Similarly, this happens to those with negative success perception in their operations. Those that perceive themselves highly successful are more likely to formalize their operations compared to those that do not feel successful.

To add, those that have made efforts to formalize are highly likely to formalize within a short period of time compared to those that have not made any efforts to find out about processes to formalize their operations. The same applies to those that have been involved in corruption (payment of bribes). The less the corruption the more SMME owners prefer to formalize their operations very soon in favor of remaining undecided of what to do. This means that businesses become more certain about their decisions to formalize the lesser the corruption around their operations. Lastly, financial inclusion is also significant with a negative coefficient. This means that the odds of in favor of formalizing very soon are higher than remaining undecided of which decision to make.

Panel 2

Success perception is highly statistically significant with a negative coefficient which leads us to conclude that the odds in favor of formalizing operations within a short period of time are higher compared to deciding to remain informalised. Holding all other things constant, increases in success perception amongst informal SMMEs reduces the decisions to stay informalised and prefer to formalize as soon as possible. The same happens with financial inclusion. The more SMMEs have access to credit, we find that it reduces their decisions to stay informalised but increase their chances of making a decision to mainstream their businesses. These findings confirm to what other scholars found (De Soto, 2000; Paula and Scheinkman, 2010). One of the most important variables in our study for black South African businesses is government support. Our findings indicate that the odds in favor of a decision to quickly formalize are greater than staying informalised. The findings indicate that, the more the government gets involved in helping out informal businesses in the country, the more SMMEs make decisions to formalize their operations. These findings are consistent with conclusions from (Monteiro and Assuncao, 2012). Businesses that received assistance from the government and its agencies were more optimistic to formalize compared to those that never received any help. Government can help SMMEs both financially and other means that are not financial. They can help SMMEs by exempting them from paying certain taxes or reducing the amount of taxes that they are supposed to pay. Governments can come in to facilitate that SMMEs have received help in terms of their capacity to manage their finance, clientele and well as their businesses at large. All those can bring benefits to SMMEs for them to make decisions to formalize their operations. If the benefits of formalisation appear bigger as compared to costs in the eyes of SMME owners, the graduation rate of informal SMMEs might increase as witnessed in Brazil after the introduction of the SIMPLES program (Fajnzylber et al., 2011).

CONCLUSIONS AND RECOMMENDATIONS

Informality is both a social and economic problem in both developing and developed countries. This is explained by the fact that jobs that are created in the informal economy are not sustainable and poverty rates in the informal economy are high. It is an economic problem from the background that when informality is high, that jeopardise public services in a country since the tax base of a shrinks. This paper’s objective is to find the socio-economic determinants that facilitate mainstreaming of informal SMMEs in South Africa. Our findings point to lack of government support, lack of funding opportunities, corruption and inability to hire and compensate qualified personnel as some of the factors that are acting as hindrances for increased rates of transition.

The finding on lack of funding for informal SMMEs is consistent with what ILO (2014) and Boateng (2015) who find that limited financing is hindering small businesses to expand. If business cannot expand then their chances to formalize are very minimal. We also found that SMMEs that have received assistance from government (non-monetary and monetary) are much more willing to formalize their activities as opposed to those that never received help. We also find that those that have been paying bribes to officials are not likely to be willing to formalize their businesses as opposed to those that have not been asked or volunteered to pay bribes. Lastly our findings indicate that those that are unable to pay qualified personnel or their general employees are not willing to formalize their activities compared to those that are able to afford.

Policy recommendations arising from our output mainly point to the government and its agencies that are responsible with SMMEs. They need to dedicate more resources to informal SMMEs so that they are capacitated to mainstream their activities. We suggest that seed funding programmes be created in South Africa and other multiple forms of credit enhancement strategies that are specifically targeted at informal SMMEs so that the number of SMMEs that transit from the informal increases at a faster rate than currently. To be precise we recommend that the South African government create the same institution like the

National Students Funding Aid Scheme (NSFAS). This kind of a funding arrangement combined with risk sharing arrangements between public and private stakeholders can facilitate that informal SMMEs be funded through state funded incubators where SMME's finances will be co-managed so as to reduce the risks involved. Also to boost business confidence amongst informal SMMEs, strong measures against corruption needs to be implemented against government officials so that the country can realize improved transition of informal SMMEs.

Limitations of the Study

The study managed to do an analysis based on the big four sectors in the informal sector. However, the study could have included more sectors so that results can be more conclusive in nature.

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