



Research on entrepreneurship in the informal economy: Framing a research agenda

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ABSTRACT

The informal economy consists of economic activities that occur outside of formal institutional boundaries but which remain within informal institutional boundaries for large segments of society. We draw from diverse disciplines to frame research concerning entrepreneurship in the informal economy around three separate theories: institutional theory, motivation-related theories from a sociological perspective, and resource allocation theory. Each of these theories provides a complementary lens through which to examine the incentives, constraints, motivations, strategies, and abilities of entrepreneurs to operate and grow their ventures in the informal economy. Employing these theoretical perspectives facilitates efforts to highlight the breadth of informal economy research in different domains and lays foundations for future entrepreneurship research.

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1. Executive summary

The informal economy consists of economic activities that occur outside of formal institutional boundaries but which remain within informal institutional boundaries for large segments of society. Given this definition, informal economy activities are technically illegal yet are not “antisocial in intent” (De Soto, 1989: 11), thereby remaining acceptable to many individuals within society. Scholars have studied various phenomena that can be categorized as falling within the informal economy, such as unregistered businesses, operating in violation of labor regulations, and the sale of counterfeit products. These activities account for 10–20% of gross domestic product in mature economies and up to 60% in emerging economies (Schneider, 2002). Dealing with the informal economy from a policy standpoint remains characterized by tension though, as informality creates both societal costs and benefits.

Scholars have conducted a substantial amount of research to examine the informal economy. The vast majority of this research has focused on phenomenological and issue-based questions without theoretical underpinning. Driven by the increasing interest more recently of entrepreneurship and management scholars with the informal economy, our effort seeks to frame existing informal economy research within three overarching theoretical frameworks (institutional theory, motivation-related theories, and resource allocation theory). We particularly emphasize how this research informs theory regarding the entrepreneurship process.

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Each theoretical framework provides a unique lens through which to understand entrepreneurship in the informal economy. Institutional theory informs how the characteristics of the institutional context (e.g., polycentricity and enforcement) influence entrepreneurship in the informal economy, how and why differences in legitimacy may provide opportunities to be exploited, and the mechanisms through which informal entrepreneurs overcome operating outside formal institutional boundaries. Motivation-related theories provide structure to research examining the myriad motivations that lead individuals to operate informally (i.e., rational considerations of costs/benefits, distrust in formal institutions, etc.) and the societal outcomes created by entrepreneurship in the informal economy. Resource allocation theory, more relevant to understanding informality in developing economies, informs the strategies (i.e., allocating family resources in the business, carrying smaller inventories, etc.) through which entrepreneurs leverage resources to exploit opportunities in resource-constrained environments.

Our framing provides contributions to theory and practice. By providing these framings, informal economy research can progress in a more structured and efficient manner by identifying areas in which research has more fully developed versus areas in which gaps remain in our knowledge (Wacker, 1998). Contributions are also made in terms of each theoretical framework: (1) institutional theory: we examine concepts, such as enforcement and polycentricity, overlooked in entrepreneurship research; (2) motivation-related theories: we expand these theories to incorporate informality as a form of deviance; and (3) resource allocation theory: we expand upon the theory's traditional focus on allocation of cognitive resources to examine allocation of tangible resources. Finally, for practitioners, our framing provides a finer-grained understanding that identifies significant heterogeneity in attributes of entrepreneurship in the informal economy that can inform more accurate policymaking.

2. Introduction

The informal economy consists of economic activities that occur outside of formal institutional boundaries but which remain within informal institutional boundaries for large societal groups (Castells and Portes, 1989; Webb et al., 2009). The informal economy represents a significant complement to the formal economy with recent estimates suggesting that it accounts for approximately 10–20% of annual gross domestic product in mature economies (e.g., Australia: 15.3%, Germany: 16.3%, Japan: 11.3%, and the United States: 8.8%) and up to 60% in emerging economies (e.g., Brazil: 39.8%, Russia: 46.1%, India: 23.1%, and Nigeria: 57.9%) (Schneider, 2002). Given that firms in the informal economy are often smaller and have lower levels of productivity than formal economy firms, the GDP estimates of the informal economy unsurprisingly translate to approximately 65% of employment in Asia, 51% of employment in Latin America, and 72% of employment in North/Sub-Saharan Africa respectively (ILO, 2002). Despite its economic impact, examination of the informal economy from an entrepreneurship perspective remains limited, with a few notable exceptions (e.g., De Castro et al., 2008; Honig, 1998; Khavul et al., 2009; Siqueira and Bruton, 2010; Webb et al., 2009).

Over the last three decades scholars working in numerous domains (e.g., anthropology, economics, sociology, etc.) have examined a number of questions concerning the informal economy. A significant portion of informal economy research has focused on phenomenological and issue-based questions. An outcome of this research is a diverse and disconnected base of knowledge with extensive duplication of research efforts. Herein, we use three theories – institutional theory (North, 1990), motivation-related theories from a sociological perspective (Merton, 1968; Passas and Agnew, 1997), and resource allocation theory (Kanfer and Ackerman, 1989) – to frame research specifically concerning entrepreneurship in the informal economy. The purposes of this effort are to (1) synthesize the diverse streams of research concerning entrepreneurship in the informal economy and (2) incorporate informal economy research within organizational theories to provide a foundation for future entrepreneurship research.⁴

Beyond providing a theoretical foundation upon which future research concerning entrepreneurship in the informal economy can be built, our work provides a number of contributions to each of the theoretical frameworks as well as to practice. Scholars employing institutional theory traditionally examine how institutional pressures lead to activities that conform with prescriptions. As encompassing activities occurring outside formal institutions, the informal economy represents a contradiction to the theory's traditional focus (Portes and Haller, 2005) and provides a context in which to more thoroughly examine the complexities of institutions. We build upon Webb et al.'s (2009) consideration of institutional incongruence and weak enforcement as facilitating recognition and exploitation of opportunities, respectively, by offering a finer-grained analysis of institutional contexts. In doing so, we also emphasize policies and policy change, institutional polycentricity, and entrepreneurs' tactics as shaping entrepreneurship in the informal economy. In terms of motivation-related theories, these theories have generally been employed to examine how and why individuals deviate from societal rules. Our framing highlights informal economy activity as based on the same motivations as other forms of deviance and recognizes that not all deviance necessarily leads to negative societal outcomes. Finally, resource allocation theory has previously been used in psychology to explain how individuals/teams manage their cognitive resource constraints. We show that this theory can be extended by informal economy research to explain strategies individuals use to manage tangible resources, risks, and different domains, such as business versus family.

Some similarities exist in the literature dealing with informality across different levels of economic development; nonetheless, there are also systematic differences in the informal-economy-related phenomena between mature and emerging economies.⁵ In other words, the level of economic development appears to be an important boundary condition influencing the extent to which theory or certain aspects of theory can explain and generalize across contexts. We elaborate on these similarities and differences with regard to each theoretical framework.

⁴ We refer to entrepreneurs operating in the informal economy as “informal entrepreneurs” or being characterized by “informality” whereas entrepreneurs operating in the formal economy are referred to as “formal entrepreneurs” or being characterized by “formality.”

⁵ Our use of the terms *mature* and *emerging* economies is equivalent to the distinction between developed and developing/emerging economies.

3. Overview of informal economy research

Economic anthropologists seeking to explain the myriad, often well-organized economic activities taking place outside the purview of law enforcement introduced the “informal economy” concept in the early 1970s (i.e., [Hart, 1973](#)). Developmental economists adopted the concept, viewing the understanding of the informal economy as critical to the development of emerging economies ([Hart, 2006](#); [Rakowski, 1994](#)). Over the next few decades, scholars from several disciplines examined organizational issues related to the informal economy.

3.1. Definition

Scholars have used terms such as *underground economy*, *shadow economy*, *irregular economy*, *unobserved economy*, and *hidden enterprises* to refer to the activities we categorize as part of the informal economy. Scholars have also advanced an array of definitions of the informal economy. We employ a definition offered recently in the management literature, which is that the informal economy is concerned with economic activities that are outside of formal institutional boundaries (i.e., illegal) yet fall within informal institutional boundaries (i.e., legitimate) ([Webb et al., 2009](#)). More specifically, the activities, while illegal, remain legitimate for large portions of society that serve as an entrepreneur's stakeholders (i.e., consumers, suppliers, employees, interest groups, etc.) ([Rutherford and Buller, 2007](#)). Phenomena falling within the scope of this definition include the use of undocumented workers, counterfeiting, ticket scalping, the sale of unregulated pharmaceuticals, unregistered and/or tax-avoiding businesses, trader-tourism, bootlegging, the skirting of environmental/labor regulations, and often street vending, among others. This definition from the management literature is consistent with [De Soto's \(1989: 11\)](#) description of the informal economy, which captures illegal economic activities yet excludes activities that are “antisocial in intent,” such as cocaine distribution, human trafficking, and bank robbery. Certainly, while drug cartels, human trafficking rings, and other illegal and illegitimate operations can be large organizations with supporting employees and consumers, our position is that their growth has been facilitated by mechanisms other than legitimacy, such as coercion, addiction, and clandestine operations.⁶

This definition is also largely consistent with [Portes and his colleagues \(Centeno and Portes, 2006; Portes, 1994; Portes and Haller, 2005; Portes and Sensenbrenner, 1993\)](#), who define the informal economy as the production of legal goods using processes that are not wholly legal. Scholars drawing upon [Portes' definition](#) have commonly examined unregistered activities and the skirting of environmental/labor regulations. Other activities also seem to fall within this domain. For example, counterfeit products are generally legal products (e.g., shoes, cigarettes, bootleg recordings, etc.), yet the counterfeiting process through which these products are produced skirts trademark laws. Still, other scholars provide narrower definitions of informality. [Nichter and Goldmark \(2009\)](#) simply define informality as economic activities that are unregistered yet produce legal products.

3.2. Informality and Other Forms of Entrepreneurship

“Informal” entrepreneurial activities can overlap with other categorizations of entrepreneurial activities including “family firms,” “community entrepreneurship,” “homework,” “emerging firms,” and “self-employment.” We contrast informal entrepreneurship with these other major forms of entrepreneurship in order to clarify its nature. In family firms, family members seek to influence the firm's strategic direction and/or maintain control of it through their involvement ([Chrisman et al., 2005](#)). While informal entrepreneurs often draw upon networks, including family ties ([Khavul et al., 2009](#)) to recognize and exploit opportunities in overcoming lack of access to formal institutions created by their informal status ([Webb et al., 2009](#)), family is not a necessary component of informal entrepreneurs' networks, and even when family is, it does not necessarily influence the venture's strategic direction.

Similarly, there can be overlap between informal entrepreneurship and community entrepreneurship. With community entrepreneurship, community serves as the entrepreneurial actor in providing for the economic and social good of the community ([Peredo and Chrisman, 2006](#)). Community entrepreneurship highlights the use of networks of individuals committed to the community good, although not necessarily for profit ([Nyssens, 2006](#)). People, not the government, govern community enterprises, and given the focus of nonprofits in promoting community entrepreneurship as perhaps a more effective solution to development in impoverished markets of emerging economies ([Peredo and Chrisman, 2006](#)), community entrepreneurship shares some elements (i.e., presence in impoverished contexts and network-based operations) with informal entrepreneurs. While the government does not control the modes of community entrepreneurship, these community enterprises may still be registered entities, unlike the ventures of informal entrepreneurs. Also, informal entrepreneurs often seek to promote their own needs as opposed to those of the community (e.g., see [Neuwirth, 2011](#)).

Emerging firms are in the nascent stages of development. Entrepreneurs in emerging firms undertake various start-up activities, from hiring employees to purchasing office equipment to registering their business; these activities can occur in

⁶ The exact size of the legitimacy threshold (i.e., how many people are required in a group to establish legitimacy of a business operation) likely varies depending on the opportunity pursued by the entrepreneur. Nevertheless, what is estimated to be over ten million undocumented workers in the United States (an issue faced in other countries as well, such as England, Italy, and Japan) serves as an example of how stakeholders debate the legitimacy of informality. Proponents rationalize that undocumented workers produce cost savings and take jobs other potential employees do not want; opponents question this rationalization and highlight other societal costs, such as increased social security and healthcare costs. Numerous marches, rallies, and lobbyists represent both sides of the debate and suggest some balance of influence between those for and against, leaving policymakers uncertain as to how to approach this issue. Of course, definitions of legality and legitimacy vary across societies, and what might be illegal and illegitimate in one society might be perfectly legal and/or legitimate in another society.

random order depending on an entrepreneur's preferences (Carter et al., 1996). Business registration may be delayed for some entrepreneurs until they perceive a viable market opportunity. In such cases, entrepreneurs in emerging firms would operate informally until they became registered. Entrepreneurs can register their business early in their venture's development for various reasons, however, such as to stake claim to a trademark-able name, in which case they would operate formally.

Self-employment, or when a single operator-owner manages a business, is another concept related to informality. Many subsistence-oriented forms of informality are undertaken as self-employment. In fact, self-employment has been used as a proxy for informality (e.g., Heemskerck, 2003; Loayza and Rigolini, 2011; Williams, 2005), although empirically, self-employment has minimal correlation with other proxies of informality. For example, Henley et al. (2009) suggest that self-employment as a proxy overlooks the fact that (1) many self-employed individuals can be registered and (2) many firms larger than self-employed entities are operated informally (e.g., sweatshops or construction companies employing undocumented workers).

Finally, homework, or work that is done in the home, is another potential manifestation of informality, although not necessarily. Homework has been discussed in terms of informal entrepreneurship given the ability for individuals to work inside their home to avoid detection by enforcement in terms of registration and/or labor regulations (Fernandez-Kelly and Garcia, 1991). Homework seems to be linked to entrepreneurs subcontracting to employees who work from their home in a wide range of industries from electronics to the manufacture of items such as soccer balls and garments. Technological advancements have increased the potential for individuals to work from home; but, those working from home can still be registered entities. Moreover, many examples of informal entrepreneurs operating outside the home are notable as well, including the use of undocumented workers in construction or trader-tourism.

3.3. Entrepreneurship in the informal economy

Entrepreneurship occurs at the nexus of individuals and opportunities (Shane and Venkataraman, 2000). As a process, entrepreneurship unfolds as an alert individual recognizes and then exploits an opportunity (Bygrave and Hofer, 1991). An opportunity surfaces when situational conditions (i.e., encompassing a confluence of variables such as institutional prescriptions, new technologies, sociocultural constraints, etc.) allow an entrepreneur to create value through developing new means and/or ends (Casson, 1982). Entrepreneurs recognize opportunities when they bridge previously separated stocks of knowledge to envision a source of potential value (Baron and Ensley, 2006). Upon recognizing an opportunity, entrepreneurs then exploit opportunities by acquiring and leveraging resources to create new ventures that deliver value for society (Sirmon et al., 2007). While this definition emphasizes the individual, the entrepreneur may act alone, as part of a team (Shane, 2003), or some other form of collective (Peredo and Chrisman, 2006). As a team or collective, an entrepreneur can draw upon other entrepreneurs to evaluate and/or exploit opportunities by jointly mobilizing resources.

To understand this nexus for informal entrepreneurs, we frame research on entrepreneurship in the informal economy around institutional theory, sociological motivation-based theories, and resource allocation theory, respectively. Fig. 1 illustrates our model of the entrepreneurship process and how the three theories inform our arguments. Individuals choose between undertaking entrepreneurship in the formal versus informal economy, weighing economic and social considerations of the opportunity within each context. Motivation-related theories inform our understanding of this initial decision by explaining the role of various economic and social considerations in shaping the value of respective opportunities. Individuals operate in an overarching context, and the institutional environment is a key component of this context that provides information regarding the attractiveness of opportunities in the informal versus the formal economy. Thus, from an institutional theory perspective, entrepreneurs' opportunity recognition and opportunity exploitation can be understood. Due to the lack of support by formal institutions, entrepreneurs operating in the informal economy may encounter severe resource constraints. Entrepreneurs can undertake various strategies to alleviate their resource constraints. Resource allocation theory describes how entrepreneurs make decisions to address the reality of constrained resources. Finally, the entrepreneurship process creates outcomes for both entrepreneurs and society overall. Coming full circle, motivation-related theories also inform the constructive and destructive effects of informal entrepreneurship.

As illustrated in Fig. 1, the respective scopes of our three theoretical frameworks address unique, yet complementary, aspects of the entrepreneurship process. For example, motivation-related theories and institutional theory overlap in informing entrepreneurs' initial decisions to operate in the informal economy. Similarly, the context in which entrepreneurs operate influences their ability to access resources and overall constraints on their activity, yet entrepreneurs can act strategically to overcome constraints and to operate more efficiently. Next, we frame research regarding informal entrepreneurship in institutional theory.

4. Institutional theory and entrepreneurship in the informal economy

Institutional theory suggests that enduring systems, or institutions, influence individuals and firms' actions without necessarily having to mobilize and intervene to achieve expectations (Clemens and Cook, 1999). North (1990) dichotomized institutions into formal institutions including laws, regulations, and their supporting apparatuses, and informal institutions as society's norms, values, and beliefs. Formal and informal institutions define the "generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within" these formal and informal prescriptions (Suchman, 1995: 574). By defining opportunities and facilitating interactions among actors, institutions encourage socially acceptable behaviors and outcomes through a system of constraints and incentives (Clemens and Cook, 1999).

Characteristics of the institutional environment influence the entrepreneurship process. Differences in formal and informal institutions' definitions of social acceptability and the degree of bureaucracy in the institutional environment enable opportunity

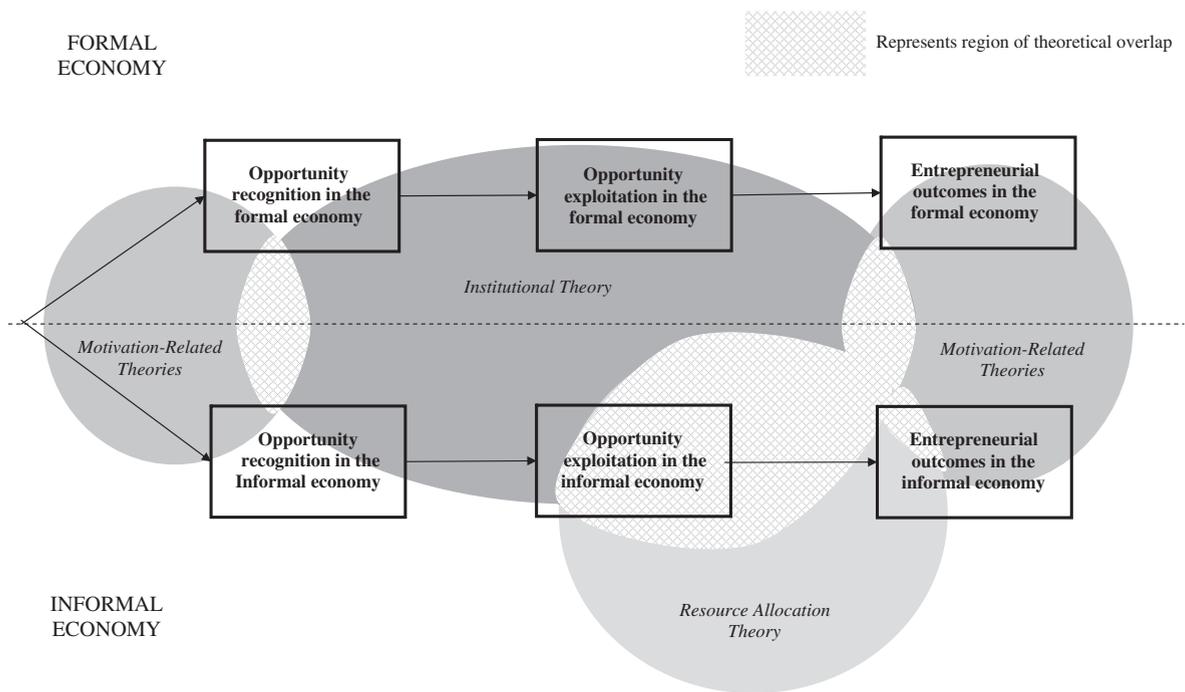


Fig. 1. The scope of theoretical frameworks in terms of the entrepreneurship process.

recognition for entrepreneurs in the informal economy. Weak enforcement of formal institutions, conflicting institutional centers, group-level institutions, and counterfeiting facilitate opportunity exploitation.

4.1. Facilitating opportunity recognition

The informal economy encompasses the set of economic activities that take place outside of formal institutional boundaries but within informal institutional boundaries. Institutional theorists suggest that formal institutions represent the codification of norms and beliefs held by those groups of individuals in positions of power in society (e.g., Scott, 1995). This assertion also suggests that there may be other, yet less powerful groups in society that possess different definitions of social acceptability. Entrepreneurship occurs in the informal economy, at least in part, because of these differences in what is defined as socially acceptable (Webb et al., 2009). What a society establishes as “legal” by its overarching formal institutions may not necessarily be “legitimate” to large groups in society possessing different perspectives of social acceptability (Centeno and Portes, 2006). As such, institutional incongruence creates a situation in which socially acceptable opportunities exist outside formal institutional boundaries for entrepreneurs who are willing to take the risks of operating outside the law. The varying sizes of informal economies across countries highlight varying levels of institutional incongruence.

A diverse set of policies establishes the boundary of formal institutions and the degree of institutional incongruence in a society. Therefore, policies and policy changes shape the scope of potentially legitimate opportunities outside formal institutions. Such policies may address trade (i.e., import/export tariffs and quotas), labor (i.e., minimum wage, social security, and union laws), and other regulatory controls (i.e., licenses/registration, pollution, and zoning) (Liedholm, 1994). Stringent policies create costs for firms (Portes, 1994), increasing the scope of potential opportunities outside of the formal economy for entrepreneurs to create value (Portes and Haller, 2005). For example, policies enacting tariffs/quotas on international trade may be in opposition to beliefs regarding fair trade. In such cases, entrepreneurs may establish operations to smuggle goods across country borders to circumvent these policies (Neuwirth, 2011). Similarly, pollution policies may be enacted to preserve a society’s long-term health. For various reasons, such as the need for subsistence, large societal groups often possess a more short-term oriented mindset, and entrepreneurs may seek to skirt costs created by these policies (i.e., higher costs for clean fuel, monitoring mechanisms, etc.) (Blackman, 2000). These examples highlight the incongruence between formal prescriptions and informal beliefs regarding social acceptability.

While institutional theory traditionally considers institutions to efficiently prescribe definitions of social acceptability (Clemens and Cook, 1999), research suggests that the stringency of policies actually incentivizes informal entrepreneurship. Therefore, we propose:

Proposition 1. *The stringency of policies is positively related to opportunity recognition in the informal economy.*

In terms of policy changes, the introduction of market liberalization policies in Central and Eastern Europe and Latin America highlight the effect that flux in institutional incongruence can have on informal entrepreneurship. Rapid liberalization in the transition of Central and Eastern European countries left property rights uncertain. While liberalization policies attempted to

engender values synonymous with a stronger free market, entrepreneurs' suspicions stemming from a historical context of policy reversals and corruption led to fear of asset misappropriation by the government, leading entrepreneurs to favor informality to avoid registering and the potential misappropriation that may follow (Feige, 1999). Liberalization in Latin America in the 1970s and 1980s led to a confluence of conditions that increased informality (de Oliveira and Roberts, 1994). Conditions that encouraged informality include industrialization, leading to over-migration to urban areas; free trade policies, allowing foreign competitors to import cheap goods; and labor deregulation, leading to decreased income for all societal classes and an inability to purchase local goods. Portes' (1994) analysis of the ineffectiveness of market liberalization led to the assertion that society's norms, values, and beliefs cannot radically change in a short period of time. Formal institutional policy changes that originate with market liberalization result from a change in written law and such changes can occur quickly. However, changes in society's informal institutions occur over extended periods. The result is that quick liberalization often serves to widen institutional incongruence and increase informality.

Thus, rapid policy changes disrupt congruence between formal and informal institutional boundaries and generate new opportunities in the informal economy. Even when policy changes bring formal institutions more in line with informal institutions, suspicion regarding the virtue of newly established policies may lead entrepreneurs to favor informality. Therefore, we propose:

Proposition 2. *The degree to which policy changes are radical is positively related to opportunity recognition in the informal economy.*

Bureaucracy represents the administrative functions of a society that establishes its rules and policies. The administration of new laws and specific agencies to oversee these laws is often aimed at fostering fair and competitive economic activities. Nevertheless, research in emerging economies highlights the excessive levels of bureaucracy that solidify existing firms' positions of power yet stifle formal economy entrepreneurship by erecting significant costs and hurdles associated with operating formally. By imposing financial costs in terms of registration and licenses as well as time needed to access the right to operate legally, bureaucracy reduces the potential value that entrepreneurs can appropriate by operating in the formal economy.

De Soto (1989, 2000) discusses the bureaucracy of emerging economies that promote informal economic activities. In examining Peru, his research highlights a bureaucratic system of over 700,000 laws and myriad agencies that impose such severe costs and time requirements that force individuals to operate informally. De Soto provides numerous examples, including a yearlong process to be able to operate a sewing machine and over a two-year process to receive legal authority to operate a bus route. Simulating the experience of establishing a small, single-proprietor business, De Soto found that the eleven-step process took nearly ten months, requiring interactions with seven different institutional centers and costing nearly thirty-two times the minimum monthly living wage.

Grosh and Somolekae (1996) discuss similar bureaucratic issues in Africa's developing economies. Examining Botswana, Tanzania, and Swaziland, the authors note the exorbitantly lengthy application process to gain access to commercial premises as stifling firm growth. For example, six thousand applications for commercial premises were received in 1990 in Botswana, with only 56 applications actually receiving a determination that year. In fact, in 1993 the governmental agency in charge of making such decisions was still dealing with applications that were submitted in 1981! The inability to access larger premises undermines local entrepreneurs' ability to grow and pushes them to seek alternative opportunities in the informal economy.

Portes and Haller (2005) recognize the effects of bureaucracy as a key paradox of the informal economy. Institutions construct laws and policies to define legal economic activity. However, with each newly enacted law, an increasing scope of potential activity exists for informal entrepreneurs to create value by circumventing the law and the costs associated with compliance. The effects of bureaucracy are magnified when the jurisdiction of these laws is spread across multiple institutional centers. Entrepreneurs then face numerous sources of costs and lengthier processes of acquiring licenses/authorization. As discussed by De Soto (1989) and implicitly by Grosh and Somolekae (1996), many entrepreneurs favor operating in the formal economy, desiring the security of property rights. The costs imposed by bureaucracy, however, force entrepreneurs to operate informally as the only option for earning a livelihood.

Thus, some level of institutional policies serves to create fair competition and to ensure that individuals have the appropriate licenses to operate without causing harm to society. However, we expect an ideal level of bureaucracy beyond which point the costs of complying with additional policies and meeting numerous agency requirements enhances the value of the entrepreneurial opportunity in the informal economy. Therefore, we propose:

Proposition 3. *Bureaucracy has a curvilinear, inverted-U shaped relationship with opportunity recognition in the informal economy.*

4.2. Facilitating opportunity exploitation

Entrepreneurs can draw upon various tactics, such as avoidance and manipulation, to offset enforcement pressures (c.f., Oliver, 1991). Informal economy research provides evidence of entrepreneurs' effective use of such tactics. Studying street traders in Colombia, Bromley (1978) makes note of traders' ability to spot the oncoming threat of law enforcement. The informal traders are able to escape penalties and corrupt harassment by selling only quantities of trade that they can easily and quickly carry away (i.e., avoidance). In other contexts, enforcement represents an implicit negotiation between those that enforce the law and those engaging in informality. The tradeoff between the benefits and costs of enforcement can lead to enforcement in the more prestigious areas of a city while allowing informal economic activities to occur unabated in other areas (Bromley, 1978; Stoller, 1996). In the same vein, informal entrepreneurs, realizing the value of complying with the negotiated enforcement, avoid competing directly with similar formal businesses that might mobilize enforcement (Kettles, 2007).⁷

⁷ While examples of negotiated enforcement appear more commonly in emerging economy contexts, there are examples in mature economies as well (e.g., Kettles, 2007; Stoller, 1996). Interestingly, the mature economy examples are often of immigrant communities from emerging economies.

Entrepreneurs can manipulate enforcement in various ways. For example, entrepreneurs skirting labor laws can employ child labor in hidden shops or via the use of homework and can mask payment of below minimum wages (Fernandez-Kelly and Garcia, 1991). Similarly, entrepreneurs skirting pollution regulations can use more costly clean fuels on days for which they expect inspection but revert to cheaper, yet dirtier fuels otherwise. Thus, avoidance and manipulation can be used as tactics to avoid enforcement, allowing entrepreneurs to operate effectively outside formal institutional boundaries.⁸ Therefore, we propose:

Proposition 4. *Entrepreneurs' proactive use of avoidance and manipulation tactics is positively related to opportunity exploitation in the informal economy.*

Research also highlights a key aspect underlying informality as the existence of different institutional centers with different interests, or institutional polycentricity (Ostrom, 1999). Institutional polycentricity can result from different levels of government with different interests. Research in this stream focuses on a single institutional category (e.g., police enforcement). Highlighting the mutually-reinforcing nature of institutional centers, this research generally finds that smaller, more localized centers are more effective in addressing societal issues (Ostrom, 2005). Informal economy research also presents a second view of institutional polycentricity with the presence of different governmental centers, such as tax, food and drug, or environmental agencies, each with different interests that shape their differing views of formality. In comparison to the mutually-reinforcing perspective associated with smaller, localized centers, informal economy research highlights the conflicting domains of these separate institutional centers, enabling entrepreneurs to take advantage of ambiguities regarding jurisdiction.

The presence of institutional polycentricity encourages informality since it prevents effective enforcement of existing laws (Fernandez-Kelly, 2006). In examining street vending in Caracas, Venezuela, Garcia-Rincon (2007) noted the lack of coordination of different state agencies and inconsistent policies as bothering street vendors yet also allowing them to continue operating during the 1980s and early 1990s. By implementing a major crackdown on vendors, a new mayor in the mid-1990s made inroads to formalize firms. The crackdown included destroying informal marketplaces and evicting the vendors. Conflict across institutional centers manifested between local and federal levels when Chavez was elected in 1999 and publicly contradicted the mayor's actions. Recognizing and appealing to the collective influence of the informal entrepreneurs organized together in these marketplaces, Chavez stated in an address that the street vendors should be allowed to operate. The street vendors quickly mobilized, returning in significant numbers, leading the mayor to state that his efforts were sabotaged by the national government (Garcia-Rincon, 2007). Roever (2006) similarly points to ambiguity regarding prescriptions set forth by national and local laws in Peru (e.g., whether national or local laws take precedence; proliferation of ad hoc legislation) as allowing vendors to take advantage of uncertainty at the institutional level with respect to what is allowed.

Fernandez-Kelly and Garcia (1991) examined the contradictions between the Labor Act of 1938 in the U.S. and laws written at the state and local levels regarding work completed at home for a corporation. In addition to direct contradictions, the authors provide evidence highlighting ambiguities in federal laws that leave the legality of activities up to individuals' interpretation, exacerbating conflict with state and local prescriptions. Beyond conflict among different levels of government, conflicting mandates and the lack of communication among state agencies undermine enforcement and legislative guidance. For example, the IRS's legal distinctions made for tax purposes create loopholes for employers that contradict the Labor Code – jurisdiction of the Department of Industrial Relations (Fernandez-Kelly and Garcia, 1991).

While separate institutional centers enable formal institutions to localize and focus on domain-specific issues, ambiguity regarding jurisdiction and conflicting interests across centers' domains also present excuses and loopholes to informal entrepreneurs. Therefore, we propose:

Proposition 5. *Ambiguous jurisdiction and conflicting interests across institutional centers are positively related to opportunity exploitation in the informal economy.*

Scholars recognize the potential for institutions to form within groups as individuals within the groups form patterns of interaction and expectations (Scott, 1995). These group-level institutions can substitute for weak, societal-level institutions (Lawrence et al., 2002), providing structure for exchange within the groups. The informal economy serves as a valuable context in which to understand the formation and utilization of group-level institutions by entrepreneurs working collectively. Group-level institutions can provide informal economy entrepreneurs with definitions of legitimacy that conflict with society's legal prescriptions and with forms of support (Webb et al., 2009). There are examples of group-level institutions helping to define legitimacy in informal economy-related research in both emerging and mature economies (Ahmad, 2008; Coletto, 2010; Friman, 2001; Itzigsohn, 2006; McGregor, 2007; Odegaard, 2008; Reyneri, 2004).

Groups form for various reasons, including originating from common ethnic backgrounds, sharing hobbies or other interests, dealing with common plights and adverse experiences, or bonding because of other historical contingencies (Friman, 2001; Reyneri, 2004; Webb et al., 2009). Over time, common norms, values, beliefs, and routines can lead to the formation of a group that has different institutional views than the broader society. Thus, informal economy entrepreneurs can form a group as they recognize specific opportunities to fulfill needs that they deem as legitimate despite being in conflict with society's legal prescriptions. Sugden

⁸ The informal economy presents evidence that institutions satisfice in monitoring and enforcement of economic activities, suggesting that institutions may not be truly efficient. While there may be laws against informality, without supporting apparatuses to monitor and enforce them, informal entrepreneurs will not formalize (Otero, 1994) in that there are minimal risks, allowing the entrepreneurs to more fully appropriate value from their activities (i.e., facilitating opportunity exploitation). Relevant studies concerning the satisficing/complicity of enforcement include Antonopoulos and Mitra (2009), Fadahunsi and Rosa (2002), Heemskerck (2003), and Odegaard (2008).

(2007) highlights that some groups in mature economies are based on friendship such as those in the United Kingdom's underground economy related to football, including ticket scalping and counterfeit goods. The relations within this football network were so strong that the network had its own language to facilitate its members' informal transactions openly in the public without law enforcement being able to understand.

Studies, especially those focused on emerging economies, also point to informal entrepreneurs establishing trade/market associations to protect the value of their opportunities and subcontracting relations to secure larger opportunities. These studies again highlight the collective nature of informal entrepreneurship and point to the fact that, while alone, individual informal entrepreneurs are susceptible to formal institutional enforcement and opportunistic behaviors of other stakeholders, collective efforts can increase their influence within their contexts. Odegaard (2008) describes a market association in Peru at a largely informal market in which a mix of agricultural products, contraband smuggled from Bolivia, and pirated goods were sold. The market's governing association enforced membership and commonly threw "walking traders" (i.e., traders that have not paid membership fees and/or met other requirements) out of the market. Itzigsohn (2006) also notes the use of networks in securing subcontracting relationships with larger firms. While challenges exist in forming these networks, including the lack of trust in others, extremely long workdays leaving little time for such organization, and resource limitations to support collective activity, informal entrepreneurs can acquire contracts that would ordinarily be too large to handle alone (Itzigsohn, 2006). Therefore, we propose:

Proposition 6. *The formation of group-level institutions is positively related to effective exploitation of opportunities in the informal economy.*

Institutions confer legitimacy (North, 1990), both in legal and non-legal forms. Defining actors' social acceptability, legitimacy attracts customers and enables actors to access resources (Zimmerman and Zeitz, 2002). Informal economy research provides an interesting contrast to legitimacy-related research as informal entrepreneurs possess legitimacy in regards to informal institutions yet are technically illegal (i.e., lack legitimacy) in terms of formal institutions.

Especially in mature economies where social definitions of legitimacy are relatively congruent with legal prescriptions, why do individuals purchase informal products since such products are not wholly legitimate (from a formal institution perspective)? Research suggests that when informal entrepreneurs manufacture products so that they imitate legitimacy-providing benefits of formal economy products while hiding the product's informal origins, consumers will purchase counterfeit goods to adjust their social status (Han et al., 2010; Wilcox et al., 2009). This phenomenon highlights a strain between different demographics in which customers are motivated to procure certain outcomes, and if legitimate means of acquiring these outcomes are unavailable, then illegitimate means become more acceptable.⁹ By skirting trademark regulations and piggybacking on other firms' development and branding investments, informal economy entrepreneurs can provide counterfeit products that attract lower-income customers who cannot afford formal economy brands and feel strain for higher social status.

4.3. Motivation-related theories and informal economy research

Motivation-related theories from a sociological perspective serve as the second framework for understanding informal entrepreneurship research. Motivation theories help to explain why individuals act in ways that deviate from a society's norms, laws, regulations, and other guidelines (Durkheim, 1951; Merton, 1968; Robinson and Bennett, 1995).¹⁰ The theories also provide insights regarding the outcomes that surface when individuals deviate from societal prescriptions. Next, we provide an overview of the economic and social motivations that lead informal entrepreneurs to pursue business activities that the law does not allow. We then examine the constructive and destructive outcomes of informality (Warren, 2003).

4.4. Economic motivations

If there is an absence of societal restraints, or mechanisms to control behavior, and potential benefits may be accrued by skirting societal restraints, individuals will act outside of those restraints (Agnew, 1993). When the potential cost of attempting to skirt restraints is prohibitive (e.g., restraints threaten the investments that individuals have made in their enterprises and relationships), individuals refrain from such behavior (Gottfredson, 2008; Hirschi, 1969). Consistent with this expectation, informal economy research strongly points to an economically rational motivation for informality (Neuwirth, 2011).

Formal entrepreneurs face higher costs associated with payment of taxes, and these higher costs discourage entry into the formal economy as the value that entrepreneurs can appropriate from their activities is reduced (Gentry and Hubbard, 2005). Research further suggests that higher taxes increase the size of informal economies (Schneider and Enste, 2002), with this effect enhanced in moving from mature to emerging economies as the costs of the government through taxes increasingly outweigh the benefits provided (Schneider and Enste, 2002). Especially in emerging economy contexts, general beliefs may form among entrepreneurs in society that it is more efficient to operate informally because the benefits (e.g., uncertain social security and infrastructural investments such as utilities) provided by formality are less than the costs (e.g., taxes, regulatory constraints, etc.) incurred to obtain them.

⁹ We discuss the notion of strain in greater detail in the section on motivation-related theories to discuss how entrepreneurs' strain leads them to operate in the informal economy.

¹⁰ The decision to operate informally versus formally involves the consideration of both economic and social issues, similar to the entrepreneur's decision to operate a lifestyle- versus growth-oriented business (e.g., weighing the value of family or a more leisurely lifestyle versus growth and wealth creation, respectively). The entrepreneur's choice influences the type, scope, and value-creating attractiveness of opportunities available.

Tax-related research in emerging economy contexts provides an interesting glimpse into the economic motivations underlying informality. Studying five countries in Central and Eastern Europe, [Johnson et al. \(2000\)](#) found a positive bivariate correlation between taxes and informality. However, this effect disappeared in a regression analysis, highlighting bribery as the strongest predictor of informality. While unable to distinguish whether bribes incentivize hiding unreported sales or if firms hide sales to pay bribes, the findings suggest that bribes represent greater institutional inefficiency (i.e., costs to entrepreneurs) than taxes that reduce the appropriable value of opportunities in the formal economy and motivate informality.

In this same vein, [Quintin's \(2008\)](#) model suggests that avoiding taxes provides an incentive to informality. However, while a strong incentive in contexts of weak contract enforcement, such as is more generally the case in emerging economies, the tax avoidance incentive disappears in contexts of stronger contract enforcement (i.e., mature economies). The value of strong contract enforcement to entrepreneurs offsets lower costs associated with avoiding taxes ([Quintin, 2008](#)). These findings suggest that while taxes can lead to greater informality, scholars also need to take into account the effects of complementary institutional supporting apparatuses in understanding the tax effect.

[Perry et al.'s \(2007\)](#) discussion of informality in Central and South America provides a complementary observation. Noting a high avoidance of taxes, the scholars suggest that poor tax collection capabilities might actually skew the levels of tax avoidance. Complementing the enforcement aspects discussed in institutional theory, this observation suggests that even if benefits provided by formal institutions are satisfactory, if there are costs which are not enforced, entrepreneurs can operate informally while taking advantage of formal benefits.

The consideration of costs/benefits by informal entrepreneurs extends to the context of other regulations (e.g., [Blackman, 2000](#); [Maloney, 2004](#)). For example, [Blackman's \(2000\)](#) study of brick kilns in Mexico showed that kiln operators only adopted cleaner burning propane (instead of the burning of trash, tires, and other undesirable materials as fuel) when subsidized by the government. When subsidies ended, there was 100% dis-adoption of more expensive propane among the kiln operators. The geographic dispersion and high number (over 20,000) of kiln operators in Mexico and often influential trade associations led enforcement to be financially infeasible (again, evidencing the collective efforts of informal entrepreneurs) and, therefore, of minimal risk to kiln operators for non-compliance. Especially in emerging economies where informal activities are often tied to subsistence and enforcement is weak, the additional costs and minimal benefits associated with formality motivate informality.

Operating formally creates costs, including taxes, registration fees, and compliance with policies. Informal entrepreneurs avoid these costs, and to the extent that informality does not introduce a new set of costs in terms of (1) enforcement threats, (2) the inability to draw upon enforcement in transaction disputes, and/or (3) lost access to benefits provided by formal institutions, then informality represents an economically rational decision. Therefore, we propose:

Proposition 7. *When perceived costs of operating informally are minimal relative to institutional benefits, entrepreneurs are more likely to operate informally.*

4.5. Social motivations

Wealth creation is emphasized as an important goal in entrepreneurship research; however, individuals pursue entrepreneurial activities to create value for themselves in other ways as well. Importantly, economic and social considerations are often intertwined in influencing entrepreneurs' decisions regarding the types of businesses that they choose to start and grow. Motivation-related theories in sociology also emphasize the socially-oriented situational factors that motivate and enable individuals to act outside of society's laws and regulations. One concern in this research is strain. As [Merton \(1968: 188\)](#) observes "[deviating] behavior may be regarded sociologically as a symptom of dissociation between culturally prescribed aspirations and socially structured avenues for realizing those aspirations." Merton suggests that strain can surface when an individual lacks access to legitimate means for achieving a society's goals (e.g., monetary success), leading the individual to then instead draw upon illegitimate means to achieve these goals. Significant levels of disparity and constant reminders of others' wealth via media and visible forms of asset ownership suggest that strain is likely to be a stronger motivator of informality in mature economies. Using a household survey to examine European Union member Romania's informal economy, [Kim \(2005\)](#) finds a negative relationship between income level and informality yet a positive relationship between income gap and informality. These findings suggest that the strain created by a visible income gap leads to beliefs that creating value is more important than the acceptability of the means through which entrepreneurs exploit opportunities (also see [Sugden, 2007](#)).

In a nuanced view of strain, the differential opportunity perspective ([Cloward, 1959](#)) asserts that individuals with more favorable positions in the social structure have the resources and power to circumvent rules. However, disadvantaged individuals in emerging economies have a larger need for such circumvention in that opportunities are not as readily available to them. A World Bank study ([Perry et al., 2007](#)) of informality in Latin America provides some evidence to test the differential opportunity perspective. The researchers examined informality in terms of voluntary exit versus exclusion. Voluntary exit occurs when entrepreneurs recognize an opportunity in the informal economy and decide to leave the formal economy. Exclusion occurs when entrepreneurs are excluded from formal economy opportunities, forcing them to seek out informal opportunities. The research shows that both exit and exclusion motivate informality. However, the results are not wholly congruent with the differential opportunity perspective. The findings suggest that informal entrepreneurs voluntarily exit whereas informal employees are more commonly excluded. In general, informal entrepreneurs start with a resource base, allowing them to pursue informal opportunities. In comparison, individuals excluded from formal economy opportunities lack the resources to take advantage of informal economy opportunities as entrepreneurs and are relegated to being informal economy employees.

Drawing on a similar dichotomy, scholars have also examined whether informality is undertaken by necessity-driven or opportunity-seeking entrepreneurs in both mature and emerging economies. The research suggests that the informal economy in mature economies can provide opportunities for (1) necessity-driven entrepreneurs who require the informal economy as a sole available source of income given the lack of alternative means for their livelihood, and (2) opportunity-seeking entrepreneurs who use the informal economy to expand their wealth and enjoy greater autonomy and flexibility outside the purview of regulations (Gerxhani, 2004; Williams, 2006). Gurtoo and Williams (2009) extended this understanding about necessity-driven and opportunity-seeking entrepreneurs to emerging economies; they found that most entrepreneurs perceive a combination of necessity and opportunity in their informal activities.

Taking a closer look, Williams's (2008) study of informal entrepreneurship in England, Ukraine, and Russia complements the findings of the World Bank study. More specifically, poorer individuals use informality as a primary source of income whereas more affluent individuals usually have formal economy jobs and draw upon informality as a secondary source of income. Moreover, affluent individuals' resources from their formal economy jobs facilitate their informal activities (these findings are corroborated by Browne's, 1996 study in Martinique, French West Indies). Thus, the motivations for individuals can vary greatly, depending on whether they feel they have to form an informal venture out of necessity or whether they are choosing to do so to pursue an opportunity.

Overall, the findings present a complex picture, with informality being motivated by lack of access to legitimate means, access to illegitimate means, and individuals' goals to either gain higher social status or just to survive. Therefore, we propose:

Proposition 8. *When society fails to help individuals subsist and there is a lack of access to legitimate means, entrepreneurs are more likely to operate informally.*

Proposition 9. *As the desire to gain higher social status increases in society while individuals have access to illegitimate means, entrepreneurs are more likely to operate informally.*

Individuals can be motivated to act outside of laws and regulations given their discontent with formal institutions (Rosenfeld and Messner, 1997). Several informal economy-related studies provide evidence consistent with this logic. Most of these studies examine informality in emerging economy contexts, perhaps due to their generally higher levels of corruption as well as politico-economic instability. Together, these issues create uncertainty and distrust in the goodwill and competence of formal institutional agents and leads entrepreneurs to perceive greater opportunity with informality (Maloney, 2004). Moreover, given untrustworthy behavior of formal institutional agents, individuals within the society can come to perceive their informality as being validated (i.e., their own personal means for working the system). In a study in Mexico, Argentina, and Brazil, Maloney (2004) finds that, when comparing formal and informal options, individuals make the comparison based on actual salary without taking into account benefits and pension. Entrepreneurs discount the value of benefits and pension given the uncertainty, due to corruption and lack of competence at the institutional level, regarding whether societal resources will be available in the future. Operating informally allows these entrepreneurs to manage their own resources to survive.

In a similar study of the informal economy in Central and Eastern Europe, Wallace and Latcheva (2006) note that the transition from socialism was faster than the establishment of apparatuses to control market activity, and corrupt agents subverted legislation in illegitimately grabbing for resources. The authors found that the formal economy was strongest further west towards the Czech Republic, Hungary, and Slovenia, a region that was perhaps influenced by neighboring Western Europe. In contrast, the informal economy was stronger in eastern and southern countries, such as Serbia, Croatia, and Romania. These results highlight that informal entrepreneurship is positively associated with loss of trust in public institutions and an increased perception of corruption (Wallace and Latcheva, 2006). Finally, focusing specifically on income inequality in 16 Central and Eastern European countries, Rosser et al. (2000) suggest that income inequality not only creates strain, but also may undermine confidence and trust in government (i.e., citizens blaming the system for inequality), motivating informality. Therefore, we propose:

Proposition 10. *As distrust in formal institutions increases, entrepreneurs are more likely to operate informally.*

Especially in emerging economies, there is support for the view that the pervasive and long-term effects of significant institutional incongruence can lead to informality becoming the norm. Cross (2007) discusses responses from members of the younger generations in Mexico who are involved in the informal economy. Having grown up in a society with pervasive informality, younger participants respond that they do not even think about the legal boundaries of their activities. Instead, they have grown up in an environment in which informality is so pervasive that it is a way of life, or a norm. The extent to which motivations transform into norms over generations is likely to increase widespread acceptance of informal entrepreneurship.

4.6. Motivational outcomes - constructive/destructive effects

Motivation-related theory recognizes that actions outside of societal rules may either have constructive or destructive effects (Coser, 1962; Warren, 2003). Consistent with this view, entrepreneurship in the informal economy likewise can have both positive and negative societal effects. Similar to formal economy entrepreneurship, research on entrepreneurship in the informal economy emphasizes outcomes in terms of entrepreneurial performance (i.e., competitiveness, survival, wealth creation, etc.) and economic development (i.e., job creation, institutional development, providing benefits to society, etc.).

Arguably in emerging economy settings, formal institutions fail to arrange the economic structure to provide adequately for society (De Soto, 1989). Filling the void left by the formal institutions, informal entrepreneurship provides opportunities, jobs, and

more efficient products/services than the formal economy can generate alone. Informality provides a means of subsistence to which the only feasible alternatives are crime and unemployment. As such, these informal activities facilitate economic and social stability in emerging regions (De Soto, 1989).

Another constructive aspect of informal entrepreneurship concerns its impact on the formal economy. Certainly much more prevalent in emerging economies, although still present in mature economies, entrepreneurs in the informal economy exploit opportunities to more efficiently provide resources to and undertake subcontracting responsibilities for national and international formal economy firms (Beneria, 1989; Benton, 1989; Coletto, 2010). In doing so, the informal entrepreneurs allow formal firms to maintain higher levels of competitiveness. Even when informal activities compete with formal firms, though, money earned in the informal economy is only a temporary loss as the informal entrepreneurs often quickly spend the money in the formal economy (Schneider, 2002).

Entrepreneurship in the informal economy also can create potentially destructive effects in that such activities unfairly compete with firms in the formal economy (Kettles, 2007). Williams's (2007) survey of formal business perceptions of informality in the United Kingdom suggests, however, that formal businesses perceive only a very minor threat from informal entrepreneurs. More specifically, only 14% of UK small businesses feel negatively affected by informality, with the most affected being those in the land transport, construction, vehicle trade, and hotel industries. Formal businesses see informality as only a minor threat (only .56% of all businesses view informal entrepreneurs as the primary threat to their business development), with businesses predominantly complaining about unfair competition from larger businesses.

A second potentially destructive aspect of informal entrepreneurs is that their activities often skirt labor, health, and environmental regulations (Blackman, 2000; Perry et al., 2007). Being excluded from opportunities in the formal economy creates the possibility that informal entrepreneurs will exploit employees as cheaper labor (Perry et al., 2007). In terms of health and environmental regulations, the subsistence nature of many informal activities finds entrepreneurs seeking the least expensive means to manufacture products or provide services. Informal entrepreneurs often work from their homes and use harmful fuels, chemicals, and other raw materials. In doing so, the entrepreneurs create significant and direct negative externality effects in their homes and on the local community (Blackman, 2000).

The loss of tax revenue is an additional destructive outcome of informal entrepreneurs. Although a complexity of issues likely undermines the development of many emerging economies (i.e., corruption, incompetent use of tax revenues, exploitation by mature economies, etc.), informality and the associated loss of tax revenues is likely a significant factor as well. Lost tax revenues undermine governments' capacities to develop their infrastructures (e.g., transportation, communication, and utility) and provide social services such as social security and healthcare (Frey, 1989). Lost tax revenues also lead to false statistics regarding economic health, which can then undermine policymakers' ability to construct effective policies (Alford and Feige, 1989; Ott, 1999). An unfair burden placed on those operating in the formal economy also results from tax avoidance as the government forces those operating in the formal economy to offset the lost tax revenue of those working in the informal economy.

Thus, entrepreneurship in the informal economy provides both constructive and destructive effects. While some scholars tout the benefits of an informal economy, "there is much less certainty about the *desirability* of a growing informal economy" (Centeno and Portes, 2006: 37). Even proponents of the informal economy recognize that these activities probably should not go unabated, suggesting some optimal size of the informal economy. We propose:

Proposition 11. *There is a curvilinear, inverted-U shaped relationship between the level of entrepreneurship in the informal economy and overall economic stability/development.*

4.7. Resource allocation theory and informal economy research

Resource allocation theory is our third theoretical perspective employed for understanding entrepreneurship in the informal economy. This theory helps to address opportunity exploitation when informal entrepreneurs are faced with limited resources to perform a task (Kanfer and Ackerman, 1989).¹¹ Resource allocation theory has traditionally focused on individuals' cognitive resources, limitations, tradeoffs between competing goals, and mechanisms for overcoming these limitations. We expand the theory's logic to understand how individuals overcome constraints on their tangible resources due to various competing needs. An individual's resource investment in performing one function necessarily means that fewer resources are available for allocation to other functions. For example, scholars have examined resource tradeoffs associated with trying to balance learning and performance goals (Porter et al., 2010b) as well as individual task/work alongside interpersonal teamwork (Porter et al., 2010a).

In emerging economies, the lack of formal economy opportunities leads individuals to pursue informality for subsistence purposes (i.e., to meet daily needs). Within these conditions, individuals face resource limitations and are forced to draw upon family resources to support their entrepreneurial activities. Examining informal microentrepreneurs in Nairobi, Gulyani and Talukdar (2010) highlight the importance of being able to leverage home-based resources for the business. The entrepreneur's living conditions (i.e., permanence of housing structure, access to utilities, neighborhood location and features, etc.) are just as important as business-related factors (i.e., access to credit and sector of operation) in terms of explaining performance.

¹¹ Resource allocation research complements the institutional theory discussion that highlights bureaucracy and stringent policies as creating undue costs for entrepreneurs in the impoverished contexts of emerging economies. Choosing to operate informally, the entrepreneur is left to determine how to acquire and manage severe resource constraints without access to an overarching formal infrastructure.

While the intermingling of business and home/family resources reflects synergistic allocation of the entrepreneur's limited resources, doing so also creates costs. For example, informal ventures, such as brick kilns, leather tanners, metal-workers, and textile dyers, are particularly polluting (Blackman, 2000). Too numerous and geographically dispersed to monitor effectively, informal entrepreneurs often disregard regulations, opting instead to operate as efficiently as possible to compete and subsist. The pollution-related costs are amplified for informal entrepreneurs given that they operate from their homes and the emissions have the potential to directly impact the family (Blackman, 2000).

Other family-related costs of informal entrepreneurs concern the costs to family members. Numerous studies note the presence of women entrepreneurs in informal self-employment although women often find the activities they perform to be shameful (Boje and Khan, 2009; Kantor, 2009; Ward and Kamsteeg, 2006). Ward and Kamsteeg (2006) discuss women in South Africa who pick through other people's trash to collect recyclable materials that they then sell. At the end of the workday, the women quickly change their clothes and, after receiving their pay, leave the worksite for the purpose of disconnecting themselves from this work. Kantor (2009) and Heemskerk (2003) also discuss cultural norms against women's work in India and Suriname, respectively. Kantor cites a local male respondent as arguing that it is better to be hungry than to be defamed by a mother or wife having to work. Despite cultural norms, resource limitations force many women to work in developing regions.¹²

The family-related costs affect children as well as women. For example, Kenny (1999) found that 7.5 million children (2.5 million between the ages of 10–13) work in Brazil selling flowers, candy, or newspapers, running errands, or guiding tourists. While not fitting the "child labor exploitation in factories" image, this labor costs children at least portions of their childhood (Kenny, 1999). Boje and Khan (2009) discuss children who work sewing soccer balls in their homes in Pakistan. Despite free educational options noted in both Brazil and Pakistan, children often do not attend school on a regular basis given the families' needs for immediate income.

Thus, in emerging economy contexts, family resources can support an informal entrepreneur's activities through the provision of labor and infrastructure. While facilitating subsistence, family costs undermine the long-term development of the family in terms of education, health, and social image. In doing so, the entrepreneur trades the overall value of the opportunity for short-term subsistence. Therefore, we propose:

Proposition 12. *Leveraging family resources is positively related to opportunity exploitation in the informal economy and subsistence yet negatively related to long-term effectiveness.*

Research on entrepreneurship in the informal economy also informs how entrepreneurs in emerging economy contexts more efficiently allocate resources and efficiently supplement existing resource stocks to manage resource limitations. Given the uncertainty of entrepreneurship, risks are introduced in that entrepreneurs cannot perfectly predict outcomes of their activities and may incur losses (Alvarez and Barney, 2005). Risks are particularly salient in emerging economies as losses can force entrepreneurs to sell family assets and may push them into a status of chronic poverty (Hulme and Shepherd, 2003). Examining informal traders in Indonesia, Evers and Mehmet (1994) discuss five major sources of risk that can influence the informal traders' resources; these sources of risk include market fluctuations, cultural pressures to redistribute profits to family and neighbors, limited understanding of business concepts such as profit and cost, failure to consider their own and family labor as costs, and underestimating depreciation of working capital. The scholars identify a number of resource allocation decisions, including minimizing inventories through buying smaller quantities and replenishing tradable stock daily, that informal traders make to manage risks. One of the benefits of such an inventory strategy is that the traders also reduce the risk of normative pressures to share cash with family and neighbors; in many cultures, businesses are not the property of the entrepreneur but of the family, whether the family participates in the business or not (Khavul et al., 2009). However, if the family does not see a large inventory, its members are less likely to ask for money or goods from the business. Traders also work extremely long hours, with nearly 90% of traders working every day of the month and nearly a third of these traders working 10-hour days (Evers and Mehmet, 1994). Allocating resources through these risk-avoidance strategies can allow informal entrepreneurs to exploit opportunities despite their resource limitations.

A second effective resource allocation strategy that the research has profiled is the agglomeration of informal entrepreneurs in a geographic location (Livingstone, 1991). On the one hand, agglomeration of very similar businesses often selling the same products would seem to create unnecessary competition. On the other hand, the research suggests that such collective efforts among informal entrepreneurs yield a number of advantages, including the ability to share tools and equipment with others, subcontract with neighbors when they secure larger orders, learn of new ideas, attract more customers, gain access to a more established facility, and possibly develop trusting group-based credit relations (Livingstone, 1991). Given these potential benefits, agglomeration seems to allow informal entrepreneurs chances to increase their capacity for resource allocation, thereby enhancing their ability to exploit opportunities. The result is that entire markets of firms selling the same product (or streets in which the businesses along the entire street sell the same product) is common in emerging economies.

Acquiring resources through borrowing is a third resource allocation strategy that informal entrepreneurs use. The fact that informal entrepreneurs have no legal status makes such borrowings substantively different than for formal entrepreneurs. While formal lending options are becoming increasingly available, informal entrepreneurs often continue to rely on informal lending options despite substantial interest rates (Baydas et al., 1995; Guirking, 2008). Informal lending can involve extremely high rates, such as 500% on an annualized basis (Hemmer and Mannel, 1989). However, it should be noted that small business loans for formal

¹² Kantor (2009) also provides evidence that the resource allocation tradeoff between family and business can favor family. In India, despite a need to earn additional income for the family, evidence suggests that women must take care of their families before seeking employment.

businesses from a bank can have rates that are 400% or greater than a similar loan in a mature economy. Despite the lower interest rates, formal loans increase transaction costs by requiring borrowers to hire notaries, obtain certifications that confirm the quality of collateral, pay substantial application fees, and own a mortgage. Also, late payment on formal loans leads to accrued interest charges and the potential for foreclosure. In comparison, informal lenders often manage businesses in close proximity to their borrowers, reducing transaction costs associated with monitoring asymmetries and requiring none of the paperwork. Inability to repay informal loans also does not usually result in accrued interest charges or threat of foreclosure (Guirkinger, 2008). Therefore, lower transaction costs of informal loans overall lead informal entrepreneurs to favor informal lending options (Baydas et al., 1995; Guirkinger, 2008; Lensink et al., 2006).

A fourth resource allocation strategy is that informal entrepreneurs often seek to use resources that others have discarded (Blackman, 2000; Ward and Kamsteeg, 2006; Zia et al., 2008). By using trash, a free resource, informal entrepreneurs can overcome their own limitations to exploit opportunities. Blackman (2000) points to the use of trash (i.e., tires, plastics, etc.) as fuel for brick kilns for the nearly 20,000 brick kilns scattered across Mexico. Similarly, Ward and Kamsteeg (2006) focus on trash pickers in South Africa who picked through trash to find sellable recyclable materials (also see Gill, 2010 for a similar discussion of trash pickers in India). Therefore, we propose:

Proposition 13. *Resource allocation strategies, such as carrying smaller inventories, agglomeration, drawing upon informal loans, and using free raw materials, are positively related to opportunity exploitation and subsistence in the informal economy.*

While informal entrepreneurs have found unique ways to overcome their resource allocation limitations, the limitations of many individuals in emerging economies can be so extreme that even informal economy opportunities are not possible. In these cases, individuals face severe unemployment. For example, Kingdon and Knight (2004) provide evidence from South Africa suggesting that participating in the informal economy requires entrepreneurs to overcome entry barriers, which many individuals would like to do but have been unable. The authors highlight that resource limitations, including lack of skills, experience, contacts, capital, and access to both structured markets and infrastructural services, undermine individuals' ability to pursue informal self-employment opportunities (Kingdon and Knight, 2004).

4.8. Discussion

Herein, we used perspectives associated with three theories to frame research concerning entrepreneurship in the informal economy. Our purpose in doing so is to provide structure and to identify areas warranting scholarly inquiry as means of increasing our understanding of entrepreneurship in the informal economy. Our analysis shows a significant diversity of research concerning informality. This research has been primarily phenomenological and spread across numerous disciplines. As such, opportunities for future research to build upon an existing foundation have been limited. By framing this diverse literature, we elucidate the richness of existing research and provide a foundation upon which entrepreneurship scholars can build. The theories provide unique, yet complementary lenses to examine informal entrepreneurship.

Beyond providing a theoretical foundation, however, we believe that we also contribute to the theories used to complete our analysis. This contribution flows from the fact that the informal economy is a different context in which to apply existing theories to study intriguing phenomena. To date, scholars studying formal economy phenomena have largely overlooked concepts such as institutional polycentricity, enforcement, and the tactics through which entrepreneurs avoid and manipulate institutions; however, these concepts are central to understanding the informal economy. In terms of motivation-related theories, deviance has largely been examined in terms of drug use, violence, and other destructive actions, yet the informal economy provides a context in which to examine the destructive and constructive nature of deviance. Finally, the strategies that informal entrepreneurs employ to manage their resource limitations in emerging economies might inform cognitive aspects emphasized by the psychology foundation of the theory.

The theoretical frameworks presented here concerning informal economy research provide some cohesion that identifies gaps in the extant research and provides a foundation for future entrepreneurship research (Wacker, 1998). For example, our framing of motivation-related theories identifies a diverse set of situational factors that influence individuals to undertake entrepreneurship in the informal economy. Interestingly, we did not uncover research that examines individual-level factors that motivate informality. Especially in mature economies, where the boundaries of legality are more clearly demarcated, an examination of entrepreneurs' moral disengagement, or the deactivation of self-regulatory processes that allow individuals to act without feelings of guilt (Bandura, 1999; Detert et al., 2008), may be an interesting starting point for understanding individual-level facilitators.

Our research identifies the level of development of an economy as a pertinent boundary condition for theories of informality. Some relationships seemed to be present across economic contexts. For example, institutional polycentricism was positively related to informality in both mature and emerging contexts. However, other phenomena are more context-specific. Resource allocation tensions are more fundamental to the subsistence contexts of emerging economies. Distrust of governments as a motivator of informality is seemingly stronger in emerging contexts characterized by corruption and socio-economic instability. In comparison, legitimacy effects of informal economy activity seem stronger in mature economies where legal and legitimacy definitions are more congruent.

Our framing also suggests opportunities to synthesize research across these theories. The collective aspect of informal entrepreneurship appeared to be informed by each of the theoretical frameworks. In our institutional theory framing, collective efforts among informal entrepreneurs were highlighted as enabling the formation of group-level institutions that offset inaccessibility to formal institutional support given the informal status. Similarly, agglomeration among informal entrepreneurs was highlighted as an allocation strategy to overcome resource limitations. While agglomeration activities such as sharing labor or contracts have been

shown to occur among informal economy entrepreneurs, less scholarly knowledge exists in terms of the types of norms (e.g., reciprocity versus hierarchy-based) that guide these collective efforts or how new entrepreneurs enter the group. The collective efforts of informal entrepreneurs also surfaces potential research opportunities within the domain of motivation-based theories. Research highlights the potential for collective efforts of informal entrepreneurs to help recognize and exploit opportunities. However, we know less regarding whether informal entrepreneurs can motivate other individuals to pursue informal versus formal opportunities, and if so, whether this motivation is based on passive observation of informality by these individuals or more active persuasion by the informal entrepreneurs. Such questions might be informed by drawing upon social learning theories of motivation (Akers and Jensen, 2009).

In terms of other research opportunities that surface with synthesizing the theoretical framings, motivation-based theories and institutional theory are strongly intertwined in terms of trying to understand the means and ends that motivate informality. As motivation-based theories point out, informality can be motivated by access to illegitimate means and an economically rational desire to create greater wealth (i.e., a culturally-prescribed end goal). Research also suggests that formal institutions providing more legitimate means alone, however, may not motivate entrepreneurs to formalize as they can free ride on their access to legitimate means (i.e., utilities, transportation infrastructure, or financial capital) while continuing to avoid formalization costs by employing certain illegitimate means (i.e., not registering, evading taxes, employing undocumented workers, or counterfeiting). In such cases, informality likely persists and grows because of weak enforcement. Additional research opportunities exist to understand what legitimate means can better motivate informal entrepreneurs to transition to the formal economy, and then given the construction of these means, how institutions can enforce compliance. For example, does weak enforcement result more from inability to pay enforcement officers, the lack of localized enforcement agencies (i.e., an institutional polycentricity issue), or beliefs among enforcement officers that are more congruent with informal entrepreneurs than the formal institutional policies?

Resource allocation research points to informal entrepreneurs' use of family resources in their business as means to overcome severe resource constraints. Family resources may enable informal entrepreneurs to subsist and meet their daily needs, thereby providing short-term economic and political stability to a society and its institutions. At the same time, however, drawing upon such a resource allocation strategy seemingly creates long-term destructive effects, such as health-related issues that could drain societal resources and the undermining of education that will likely lead to a vicious cycle of poverty. While scholars have estimated the costs of informality associated with tax avoidance, we have less knowledge regarding these longer-term effects. Drawing upon development-oriented research, which emphasizes issues such as education levels, stunted growth in children, and variance in poverty levels, entrepreneurship scholars may be able to discern the long-term impact of these other forms of informality on institutional development, perhaps by tying particular social woes in communities to the forms of informality present in them. Given the tension that informality creates with both constructive and destructive effects on society, scholars may also seek to determine what destructive effects should be targeted first via institutional policies and/or enforcement while maintaining the constructive outcomes.

Our framing is not without limitations though. Our investigation of informal economy activity draws primarily from the dichotomy of formal versus informal. However, a burgeoning stream of research rightfully acknowledges that informality is more continuous than dichotomous (e.g., Godfrey, 2011; Guha-Khasnobis et al., 2006). As such, entrepreneurs can be fully compliant with certain legal definitions (i.e., labor regulations) while in conflict with others (i.e., trademark laws). Future studies examining institutional incongruence may adopt a finer-grained perspective in understanding how entrepreneurs are both formal and informal and why, from a strategic standpoint, an entrepreneur would choose to be compliant with certain prescriptions while intentionally conflicting with others. A second limitation is that we focus on providing a theoretical foundation to informal economy research while avoiding methodological considerations. The methodological complexities of studying the informal economy, however, mirror the theoretical complexities (Henley et al., 2009; Mead and Morrisson, 1996). In larger quantitative studies, numerous proxies with small correlation have been used to capture informality. At the same time, when undertaking finer-grained analyses, scholars have to figure out how to approach and interact with informal entrepreneurs, who purposefully avoid formal institutions and may be wary of outsiders. We encourage future scholars to ensure a match between their methodological choices and theoretical foci.

From a scholarly perspective, the informal economy represents a broad construct and research domain with significant opportunities for future research. Accordingly, scholars from numerous disciplines have examined research questions related to the informal economy. Important too is the fact that momentum among entrepreneurship scholars to examine questions regarding the informal economy is increasing. With our theoretical framings, we hope to increase scholars' awareness of the breadth of informal economy research, the major themes of existing research, and opportunities for future, theoretically-driven research within and between scholarly domains. We believe that these contributions can stimulate research with the aim of addressing the complex set of issues associated with entrepreneurship in the informal economy.

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