

SUPPORTING PEOPLE TO LEGITIMISE THEIR INFORMAL BUSINESSES

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This report examines how organisations could support people to formalise their informal businesses, and establishes a model that can be used by formalisation services across the UK.

There is evidence that an increasing number of people are engaged in informal work, and the scale of these activities makes them an important part of the UK's local and regional economies. Government policy responses could include a laissez-faire approach, deterrence or encouraging compliance, but have, in the main, been punitive. There needs to be better understanding of the most effective ways to tackle the informal economy in order to choose the best combination of policies.

The report:

- presents the scale and range of the informal economy in the UK;
- defines what is meant by formalisation and current practices;
- examines the activities involved in formalisation, the length and cost of the service and the key characteristics needed by the supporting organisation; and
- presents a model of a formalisation service that organisations might replicate to help informal entrepreneurs to legitimise their businesses.

CONTENTS

Executive summary	03
1 Introduction	12
2 What is the informal economy? Practice and policy	22
3 Towards a formalisation service	41
4 Findings	49
5 A model of a formalisation service	79
6 Conclusion	89
7 Recommendations	92
Note	96
References	97
Appendix 1: Who's doing what in the informal economy?	102
Appendix 2: Research methodology	105
Appendix 3: Topic guides	108
Acknowledgements	110
About the author and About Community Links	111
List of figures	
1 A model of a formalisation service	09
2 Typology of informal work	26
3 Levels of informality	27
4 Understanding compliance	27
5 Distribution of policy approaches taken by EU countries, 2001–05	38
6 Addressing the '4 C' gap	47
7 The seven key attributes of the client–advisor relationship	50
8 Activities enabling formalisation	58
9 A model of a formalisation service (Figure 1 repeated)	80
10 The six sub-stages making up a formalisation service	81
List of tables	
1 Negative and positive aspects of the informal economy	25
2 Policy approaches taken by governments	31
3 UK policy measures	35
4 Cost–benefit analysis: HMRC approaches to the informal economy	36
5 The '4 Cs'	47

EXECUTIVE SUMMARY

Community Links conducted a two-year qualitative study, which sought to obtain knowledge from organisations in the UK that have been involved in supporting local people to ‘formalise’ or legitimise their informal businesses. This report analyses the context of such services and establishes a model, based upon the findings, which can be used as the foundation for the replication or expansion of formalisation services in local areas across the UK.

Since 2000, Community Links has been involved in gathering and understanding evidence on cash-in-hand/undeclared work in east London. A previous report funded by Joseph Rowntree Foundation, from 2006, *Need not Greed*, showed that the vast majority of informal workers in deprived communities do so in response to poverty. In 2009 we received a second JRF research grant to further this work: to better understand how informal entrepreneurs can be supported by organisations to make the transition from the hidden to the formal economy.

About the informal economy

Informal work involves the paid production and sale of goods or services which are unregistered by, or hidden from the state for tax, benefit and/or labour law purposes, but which are legal in all other respects.

– European Commission (1998)

Informal economic activities are increasingly recognised as an important component of the UK’s economy by scholars and policy-makers. The informal economy mirrors the diversity of the formal economy – many different types of informal work and businesses exist across several sectors.

Evidence suggests that a considerable number of people participate in the informal economy:

- In the UK, the annual informal economy represents 12.3 per cent of GDP or around £270 billion (Schneider and Ernste, 2002; Schneider, 2011).
- At least two million vulnerable workers are involved (TUC, 2008).
- About 20 per cent of people of working age have done some sort of informal work during the last year in areas where Community Links has conducted research (Community Links, 2006–2011).

Preconceptions around who operates in the informal economy are rife; however few are based on fact. Contrary to negative stereotypes about ‘benefits cheats’ or ‘tax dodgers’, in the short-term informal work in deprived communities helps people deal with periods of poverty (for example by enabling them to pay for necessities) triggered by illness or loss of a formal job. In the medium term, however, informal work can leave individuals outside the formal labour market, unable to access rights such as the minimum wage and sick pay, and can keep them in poverty (Katungi *et al.*, 2006). For some though, informal work can have a more positive longer term role, developing confidence and skills, and building social capital (Travers, 2001).

The consequences of failing to address the hidden economy are manifold:

- Informal work keeps many people in poverty.
- Informal enterprise can suppress growth and wealth creation (of their own businesses as well as the non-contribution of tax and reticence to employ people).
- Tax avoidance and benefit fraud results in lost revenue and unnecessary spending.
- Weakened employment rights can increase exploitative practices by employers.
- Inadequately designed policy results from an incomplete understanding of the economy, as many who are deemed unemployed may actually be working informally.

Throughout this report we use the term ‘formalisation’ to describe the process by which informal paid work becomes compliant with employment, tax and benefit laws.

Policy and practice

This report offers a very practical solution to addressing one aspect of our economy: the hidden economy and its informal entrepreneurs. The 2011 UK Enterprise Survey Report found that jobs are most likely to be created in small and medium-sized enterprises, and that roughly half of the projected growth in the economy will come from these job-creating small businesses.

A significant minority of those businesses are trading informally (Community Links, 2006–2011; European Commission, 2007). Rather than embrace these entrepreneurial businesses and bring them into the formal economy, UK policy-makers traditionally deal with them with *laissez-faire* apathy or by deterring and punishing them. This approach, as demonstrated by the results of research conducted by HM Revenue and Customs (HMRC), is ineffective. An alternative strategy is to enable compliance. This positive approach is increasingly recognised as the way to deal with informal paid work; however a number of factors in the broader policy environment in the UK currently prevents this from occurring in practice.

So far there is no study in the UK which documents the process by which informal entrepreneurs are supported to formalise or legitimise their

Preconceptions around who operates in the informal economy are rife; however few are based on fact.

informal business. This research is built on the belief that the way forward to harness the informal economy is to document the learning and successes achieved by local organisations which already offer formalisation support, share these findings and support others to replicate their approaches.

In doing so it will:

- Create wealth: providing an income for an individual and their family, who in turn spend that in the local community, widening this positive economic impact.
- Create jobs: as unemployment continues to rise, and the competition for the scarce jobs intensifies, formalising businesses will create more jobs.
- Increase an individual's 4 Cs: confidence, credibility, commitment and cash, all of which build the stability of a business and can enhance employability.
- Move people off benefits and into the tax system.
- Contribute to the local economy: The businesses provide better quality, affordable goods and services to the markets and customers in their communities. This in turn develops the wealth within a community, builds social capital, and reduces poverty and social exclusion.

Research objectives and methodology

The research objectives were to:

- Document the formalisation processes developed by local organisations and draw out common themes on the questions of 'what works?', 'for whom?' and 'how?'
- Aggregate findings into a practical model, which can be shared and adopted by others.
- Promote debate among policy-makers, and encourage consideration of the social and economic benefits of formalising informal work.
- Increase awareness of informal work and potential ways to lift people out of poverty.

In order to achieve these, Community Links deployed the following research methodology: first, an international literature and policy review highlighted the approaches that other countries use to address their informal economies; this focused particularly on formalisation services. From this a topic guide was developed, and then snowball sampling was used to identify ten organisations across the UK that were already offering formalisation support in various guises – through business support; information, advice and guidance (IAG); and micro-finance services. These organisations were highly diverse, having different primary aims, offering a range of services and drawing on a mosaic of different funding. We conducted 35 semi-structured interviews with front-line advisors, clients and organisational support staff in order to understand these services.

Findings

There were two strands to the research findings:

- Formalisation hinges on a 'deep value' relationship between the client and the advisor.

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- There are specific activities and tasks necessary to formalise an informal business.

Deep value: the attributes of the client–advisor relationship

The overriding factor in enabling a business to formalise is the quality of the relationship between the informal entrepreneur, the supporting organisation and its advisors. Without these three actors working together, in all likelihood formalisation efforts will be unsuccessful.

The research found that the quality of these relationships centres around seven key attributes ('Int.' = from interview with person from organisation; 'Cl.' = from interview with client):

Trust. "People got to trust you, it is not rocket science" (Int. 21). The work that informal entrepreneurs are doing by its very nature is illegal, so without there being mutual trust, advisors will not be able to guide and support their clients through a process of formalisation.

Empathy and non-judgement. "We recruited business advisors purely on the basis that they would empathise with the clients, love the clients, rock for the clients" (Int. 24). Advisors empathise with informal entrepreneurs who are trying to avoid poverty, and are non-judgemental about the morality of their actions. They tend to adopt an 'only look forward' approach to give their clients a new start.

Understanding. "He [the advisor] had a very good understanding of what I was going through. He would talk as a friend as well." (Cl. 7). Understanding is an aspect of the relationship between advisor and client which encompasses the similarity of experiences, backgrounds or learning between the two, which deepens the connection, and strengthens the bond of trust.

Collaboration. "We have got to work with the client and whenever possible we inform them of the implications of self-employment; we are trying to be as open as possible without being prescriptive." (Int. 8). A relationship between advisor and client is built not only on the skills of the advisor and the willingness of the client to participate in the process but on a process of active collaboration, where both parties are working together towards the best outcomes for everyone.

Positivity. "It is about seeing the potential in everybody and help them believe in it and action it" (Int. 13). Supporting informal entrepreneurs to be positive and confident throughout the formalisation process is key. Formalisation is a journey, with its inevitable ups and downs, and advisors need to encourage their clients, boosting their self-belief and self-esteem, along this path.

Experience. "There are those [advisors] who come from banking or the legal profession or big business and they can be good, or not very good ... because they don't understand innovation, risk, really what it's like to be pulling out some business. They understand how to put up a structure and systems but not what the client needs and wants." (Int. 2). The most successful advisors at formalising informal businesses have significant amounts of frontline experience of advising and supporting clients (ten years plus average) to do so.

Activities involved in formalisation

The research found that there are a number of activities and tasks involved in facilitating the formalisation process. These include:

Outreach and referrals. It starts simply by "having a chat over a cup of tea and a cigarette" (Int. 18). Initially advisors typically go out into the community to build these 'deep value' trusting relationships and earn a reputation for themselves and the services they offer.

Early advice. “We know that people need a certain amount of support ... it would be about looking at what their issues are and find support to address them ...” (Int. 22). Once trust is established and a basic level of awareness has been generated about the services available, then advisors can give early, low-level advice. Initial meetings are to identify the particular needs of the client as well as their abilities, experience and aspirations, and to understand where their business is at.

Support with financial and personal issues. “About a third [of the users] have severe problems ... generally speaking the people we help are young people who are very often in very chaotic situations and for whom to turn up on time, to present themselves is often a mission itself ...” (Int. 22). Support in overcoming a client’s wider support needs, such as a lack of key skills, or self-confidence or outstanding debts, helps to bring stability to the entrepreneur’s life and therefore their business.

Business formalisation and development support. “People would say business plan and do a document this thick. It is to put it in people’s experience, and it is basically where you want to be in a year’s time, in two years’ time” (Int. 23). Advisors take the informal entrepreneurs through the practical steps of formalising their businesses by developing a plan. This would include registering with the tax authority, acquiring necessary trading permits, opening a bank account and starting financial records, gaining the necessary insurance and meeting health and safety regulations.

Exit support. “We keep in touch with clients for 6 months after they have registered and start trading. It is not long. Some of them will keep in touch after that and will pop up into the office and say hi, by email, etc.” (Int. 4). Support for a formalising business is usually withdrawn slowly and gradually in order to ensure a smooth and sustainable exit from the service. Just as the overall length and intensity of the service provided is tailored to the business and personal needs of the entrepreneur, so is the provision of exit support.

Time it takes to formalise

Calculating the time it takes individuals and their businesses to formalise is helpful in allocating resources. Clearly the amount of time it takes varies according to an advisor’s and client’s skills, experience and resources. Most organisations said that formalisation tends to take anywhere between three months and three years.

The cost of a formalisation service

“It is realistic to do the job properly for £2,500 per person” (Int. 24). Most organisations did not offer a dedicated formalisation service, but undertook this work as a by-product of their existing services. This made it difficult to develop an accurate cost framework. Organisations quoted costs per client of anything from £1,500 to £7,500, with an average cost of about £2,500, to formalise each business.

Results of formalisation

Outcomes are difficult to attribute as limited formal evaluation has been conducted of these services. But clearly the formalisation approaches that were studied contributed significantly to the success of formalising the businesses involved. We found three measurable outcomes of a formalisation service:

- **Sustainability of ‘formalised’ businesses.** One of the larger organisations we studied stated that more than 80 per cent of the start-ups it helped

were still trading after 18 months, and 79 per cent continued after three years. This high sustainability rate can be explained by the quality of the relationship-based support, and the business experience that an informal trader already has.

- **Increase in the proportion of local residents registered as self-employed.** The smaller support organisations were registering on average 80 new businesses a year. This number appears more significant when one looks at the context of this achievement. The majority were operating in areas of poverty and socio-economic exclusion. In spite of this, these informal entrepreneurs were able to formalise their business and (for some) expand.
- **Decrease in unemployment levels where the support organisations operate.** It is difficult to attribute a direct relationship between the formalisation interventions and a decrease in local unemployment levels among those previously working informally, mainly because this data is not systematically collected. However, some suggested that between 5 per cent and 15 per cent of those accessing employment services may be working cash-in-hand, and that they can be successfully supported into formalising their business or formal employment.

A model of a formalisation service

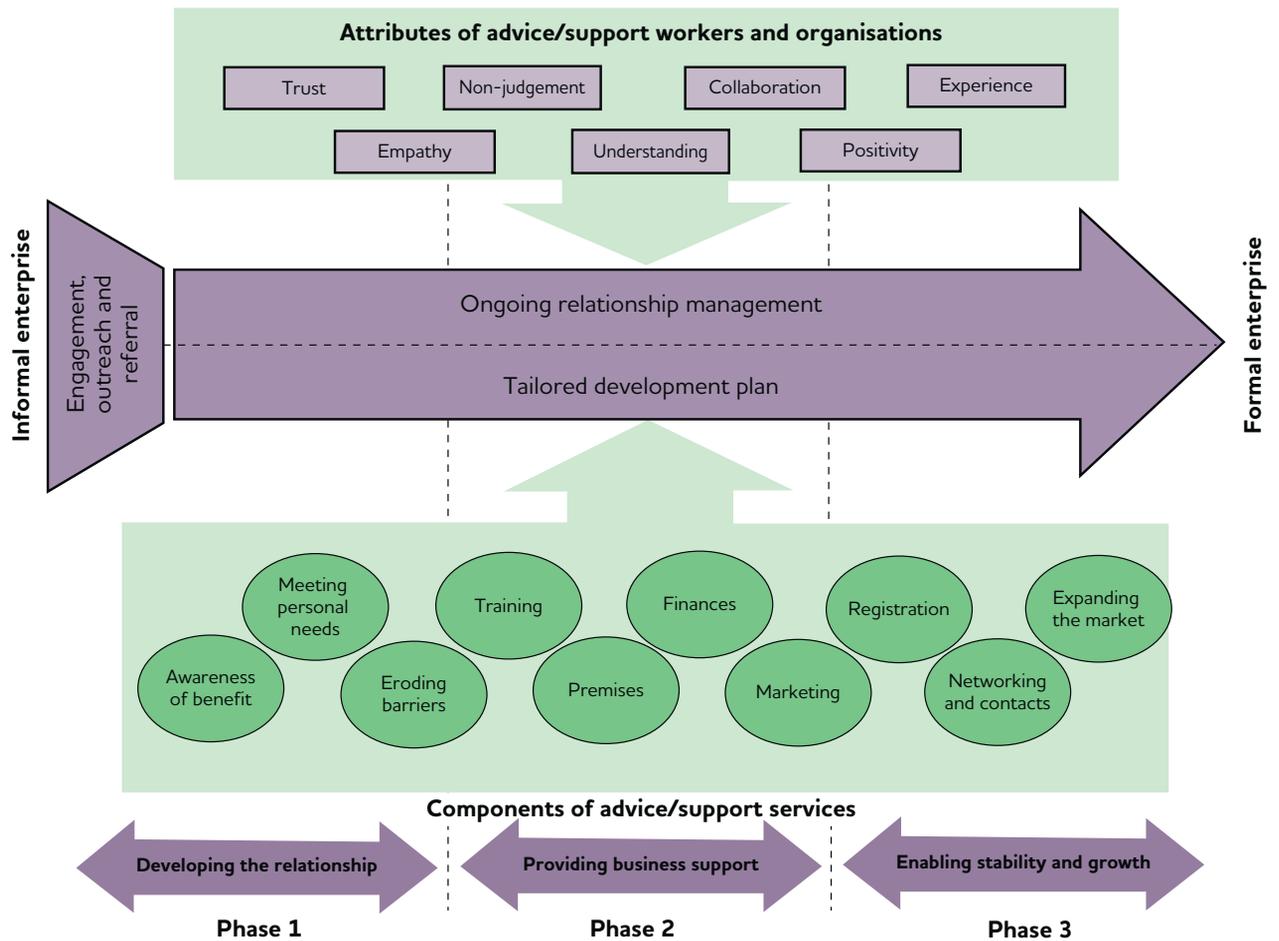
From these findings Community Links was able to develop a model of a formalisation service. In this model there are three identifiable phases in moving an informal enterprise into a formal business.

Phase 1: Developing relationships. A well-designed process of engagement, outreach and referral ensures that: the supporting organisation makes an initial connection with local informal businesses; following this, a relationship begins to be cultivated between advisors and the informal entrepreneur and a development plan tailored to the needs of the business is drawn up.

Phase 2: Providing business support. Business support for informal entrepreneurs requires acting to support the client on a whole range of personal and financial issues which may affect their ability to make a success of their business. Once such support has been offered, and the relationship between client and advisor is steady and trusting, a detailed but flexible programme of formalisation support and advice is given. This works through skills development and encouraging 'hands-on' experience, gradually and incrementally building the foundations of the client's newly formalised business.

Phase 3: Enabling stability and growth. The advice and support services offered to the client are slowly tapered off, while an offer of continued support is kept open in case any further issues or problems are encountered. The advisor works to establish the entrepreneur within a network of contacts and accessible markets in order to ensure the long-term sustainability of the formalised business.

Figure 1: A model of a formalisation service



Policy recommendations

There are a number of specific policy recommendations needed for successful formalisation services to exist in the UK.

The principle recommendation is:

- Establish an informal economy expert group to facilitate greater co-ordination and co-operation.

An expert group should be established, bringing together those who have an interest in tackling informal entrepreneurial activity, including employer and employee representatives, third sector organisations and academics with expertise in this field. As a consultative entity the mission of the expert group is to facilitate greater co-ordination and co-operation of all stakeholders involved in tackling the hidden economy. The tasks of the platform will focus on promoting and developing co-operation, developing expertise and capacity-building in order to improve the efficiency and effectiveness with which the hidden economy can be tackled.

More specifically, there are a number of recommendations geared towards making formalisation service delivery easier and more effective. These include:

- Introduce an immediate referral policy of 'informal' clients onto a specialist Work Programme provider.

- Work Programme providers and business support organisations should incorporate formalisation services into local service delivery and be given certain special considerations to deliver innovative formalisation services. For example, Community Links recommends that special consideration on the 'duty to disclose' is granted to providers delivering formalisation services. Providers should be in the position to reassure clients that no recovery action is attached to the offer of support, on the condition that informal entrepreneurs 'only look forward' and formalise their activities.
- Increase eligibility for test trading to prevent benefit claimants from setting up informal businesses. Giving claimants day one eligibility to test trade or go onto the New Enterprise Allowance will stop people from setting up informal businesses before they relinquish their benefits.
- Introduce test trading to the Work Programme to incentivise and increase the sustainability of the business.
- Providers should ensure high quality provision through the availability of 'formalisation' accredited training modules and recruit staff with core formalisation competencies in the job description and interview process.
- The impact measurements of employment support provision should include formalisation. Indicators for self-employment and formalisation in particular should be developed within the monitoring and evaluation criteria, and informal work should be included in the diagnostic assessment framework.
- Design Universal Credit so that it enables self-employment and encourages formalisation. Adopt a suitable payment model for benefit payments to the self-employed and develop a suitable conditionality regime for claimants moving into self-employment.

If these recommendations are implemented they will contribute to supporting more people out of poverty and social exclusion, into sustainable businesses, and contributing to the growth and recovery of the UK economy.

Client case study 1: John, 38, painter & decorator and trainer

John is married with children. He'd been in and out of work for many years, prior to getting help from a local enterprise support organisation to 'formalise'/legitimise' his business in 2005. Since receiving this support he has remained clear of the benefit system, pays his taxes and achieved a comfortable standard of living.

Before getting this support John had been in receipt of benefits (not eligible for Jobseeker's Allowance but received income based benefit, housing benefit, council tax and free school meals etc., approximately £100 per week) and he'd done some spells of informal trading to get by for about 16 months. His gross income a week was around £200 in 2005, paying no taxes on his work.

John approached a local enterprise support organisation on the recommendation of a friend. Over a five-month period John was helped to formalise his business by:

- a business advisor who had real practical experience of running a business as well as empathy towards this particular client group (the long term unemployed); and

- a business support worker who dealt with the practicalities, such as administration, management of the client bank account while test trading and helping the client set up a book-keeping system and manage his finances.

The organisation was supported, in part, by a government contract to create more businesses in the local area. They received £1,650 per business to do so. The organisation worked on a 15 per cent margin so actual costs were around £1,400. The organisation made a commitment to support clients for the life of their business; there was much contact in the first two years of trading and since then they have still kept in touch.

John spent ten weeks test-trading before leaving the benefit system and then had tapering Tax Credits for two periods of six months (just under £4,000) and has had no benefit or Tax Credit payments since 2006.

Nowadays John mainly works as a trainer subcontracted to colleges and training organisations and still does some decorating for long-standing clients. He has remained a sole trader but has supported many young people into jobs and self-employment within the industry. From living on the breadline for so many years, John and his family now live comfortably, earning between £40,000 and £50,000 per annum and he has never been back on benefits.

Financial costs and returns of formalisation

Cost (item)	Annualised costs (£)	Notes
Benefits payments	£5,200	
Tax credits	£4,000	
Business support	£1,650	
Undeclared taxes	n/a	Below the personal tax threshold
Sub-total	£10,850	
Returns (item)	Annualised returns (£)	
Taxes (income tax)	£18,000	Approx. 40% of £45,000 income Aggregated over 7 years: approx. £72,000
Savings to the state by non-payment of benefits and tax credits	£9,200	Aggregated over 7 years: approx. £64,400
Sub-total	£18,200	
TOTAL (£)		
Annualised costs – returns total	£7,350	
Returns TOTAL (aggregated over 7 years – the lifespan of John's business)	£136,400	Aggregated income tax paid over 7 years: approx. £72,000 Aggregated savings to the state by non-payment of benefits and tax credits over 7 years: approx. £64,400

1 INTRODUCTION

The informal economy is an area that is under-researched and undervalued by policy-makers, and yet plays a vital role in the national and local economies. Informal entrepreneurs are often driven by ‘need not greed’ as a means of generating income to address poverty.

In this introductory chapter we explain why this piece of research has been necessary. We outline the research objectives, describe the methodology we used (which included a literature and policy review and then semi-structured interviews with 10 organisations and 30 individuals across the UK who are already supporting informal entrepreneurs to formalise) and share the features of the sample.

Community Links is led by its vision to create confident and inclusive communities where everyone is able to fulfil their potential and no one is left behind. We strive to achieve this through championing social change – tackling the causes and consequences of social exclusion by developing and running first-rate practical activities in east London and sharing our local experience with practitioners and policy-makers nationwide.

Since 2000 we have taken a particular interest in the informal economic activities of small businesses, employees and the self-employed, because the informal economy has such a huge impact on the lives of the people we work with, and plays such an integral role in their experience of poverty.

Our extensive research (25 reports/papers since 2000) has found that some people turn to informal work as a means to make ends meet; it helps by enabling them to put food on the table, pay the rent or heat their house. However, it also traps them in a cycle of poverty as they now work outside the ‘mainstream’, and therefore do not have access to the national minimum wage, holiday or sick pay, or legal protection. Our research has shown that informal paid work can have a positive role in peoples’ lives, developing their confidence and skills and building their social capital.

In 2009, when we started developing this particular research, the unemployment rate in the London Borough of Newham was high – 13.9 per cent of the working-age population. This compared unfavourably with the London average of 8.93 per cent (ONS, 2009). For the scarce jobs

that are available, competition is fierce. There is one vacancy for every 13 Jobseeker's Allowance claimants in Newham (TUC, 2011b) – though in some wards it can be as high as 1:46 – compared to a ratio of 1:10 across London.

Many local residents are far from the labour market. Nearly one third of the working-age population is economically inactive (London Borough of Newham, 2010a). More than 17,000 adults have never worked (London Borough of Newham, 2010b). With one of the youngest populations in the country (ONS, 2009) and high levels of poor health (NHS Newham & London Borough of Newham, 2010), many residents require flexible employment in order to meet their caring and childcare responsibilities. Others are simply deemed unemployable due to low levels of skills and qualifications, or because they have 'undesirable' characteristics such as criminal records, disabilities, or long-term health conditions.

Against this backdrop, enterprise and self-employment can offer a very real and positive alternative.

So where is the growth in jobs going to come from? The 2011 *UK Enterprise Survey Report* stated that they are most likely to be created in the private sector, in small and medium-sized enterprises (SMEs). Both job creation and economic growth are desperately needed in east London, and it has been estimated that roughly half of projected growth in the UK economy will come from these job-creating small businesses (ICEAW, 2011).

Our own quantitative research across a number of deprived communities suggests that cash-in-hand work is thriving, with over 20 per cent of the working-age population having engaged in some cash-in-hand work over the last year (Community Links, 2006–2011). Nearly half (49 per cent) of these people would like to formalise their informal business activity but know neither how to, nor where to go for help. Although there are rare examples of innovative projects, in general little practical support is given to informal workers and businesses to help them make the transition into formal working. Clearly it is not the sort of business support service likely to be advertised through the Yellow Pages.

This public demand, the failure of traditional 'punitive' policy approaches to tackling informal work, and the limited development of formalisation services to date, clearly point to a case for the wider development of formalisation services. This research sets out to do just that.

Box 1: A definition of poverty

Throughout this report we talk about the relationship between poverty and cash-in-hand work. Community Links goes beyond the formal definition of poverty (60 per cent of national median income), as poverty extends from material considerations to the ability to fully participate in society. The late Professor Peter Townsend's 1979 wider definition of poverty is useful:

Individuals, families and groups in the population can be said to be in poverty when they lack the resources to obtain the types of diet, participate in the activities and have the living conditions and amenities which are customary, or are at least widely encouraged and approved, in the societies in which they belong.

There is one vacancy
for every 13
Jobseeker's Allowance
claimants in Newham

Journeys to formalisation

JRF kindly supported Community Links with a research grant in 2009, in order to better understand how formalisation services might become more commonly accessible to people in need. We have therefore undertaken a two-year qualitative study which has sought to extract learning from organisations in the UK that have been involved in supporting local people to 'formalise' their informal economic activities. We hope in this report to outline the key lessons of this research, and present a model to inform the future development of formalisation services.

In the remainder of this Section we set out the research objectives, methodology and ethics involved in undertaking this work.

In Chapter 2 we outline our definition of informal work and discuss the size and scale of the informal economy in the UK. A tentative typology of informal workers is put forward, and the benefits and disadvantages of the informal economy for workers, customers and wider society are considered. We also analyse the policy context within which informal work takes place. We look at the various ways in which the informal economy interacts with government policy, and outline the different policy approaches that governments can take in their attempts to tackle informal working. We then look at the practical policy steps currently taken by UK and EU-member governments in this field. We conclude this chapter by considering the desirability of a change in policy approach, and the evidence for whether such a change is already under way in various jurisdictions.

Chapter 3 is where we establish our definition of 'formalisation', and introduce the objectives, client groups and current practice of 'formalisation services' which already exist.

In Chapter 4 we share the findings from the research. These focus on the importance of the relationship between advisor and client. We describe the characteristics required of the players in the formalisation process. These characteristics enable the deep and meaningful relationships upon which successful formalisation services are based. We then examine the activities necessary to formalise an informal business, as well as the time and costs needed. Finally, we discuss the outputs and outcomes that can be expected and measured so as to evaluate a formalisation service.

We put forward a model for a formalisation service in Chapter 5, drawn from the research we have undertaken. We describe the 'mechanics' of this formalisation model, and the preconditions required for such a model to work.

In Chapter 6 we set out the conclusions we have drawn from this research. Chapter 7 is where we offer recommendations to policy-makers and others as to how best to create a supportive environment for formalisation services to emerge, and for the informal economy to be better understood.

A note about confidentiality and anonymity: to protect confidentiality and ensure anonymity all names of those who have been involved in this research have been changed.

Project objectives

The project objectives were to:

- Document the formalisation processes developed by local organisations and draw out common themes on the questions of 'what works?', 'for whom?' and 'how?'

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- Aggregate findings into a practical model, which can be shared and adopted by others.
 - Promote debate among policy-makers, and encourage consideration of the social and economic benefits of formalising informal work.
 - Increase awareness of informal work and potential ways to lift people out of poverty.

Methodology

This research attempts to uncover existing models and processes which are used to assist informal entrepreneurs in their journeys to formalisation. The full research methodology and a profile of interviewees can be found in the Appendices.

Literature and policy review

To gain a better understanding of the informal economy, and particularly formalisation services, we conducted an international literature and policy review.

From this review we were then able to develop a topic guide to use in the qualitative research.

Qualitative research – visits and interviews

We used a snowballing technique to identify 60 organisations from across the UK to participate in the qualitative research, of whom 10 accepted. These ranged from large national companies, with multiple offices, to small, hyper-local charities. Our research team then visited and observed these ten organisations as they went about their day-to-day work. We conducted 35 in-depth, semi-structured interviews with CEOs, board members, managers, frontline staff and advisors, and clients – all of whom shall remain anonymous.

Ethics

The illegality of informal work posed a serious set of ethical questions for Community Links' research team to address. As we abide by the Solicitors Regulation Authority (SRA) Code of Conduct and our own internal confidentiality and protection policies, we ensured the following:

- Every person involved in this research gave their consent freely. (A written briefing paper and then a verbal brief were given to all participants telling them about the project and the scope of their involvement. We also prepared confidentiality statements for the organisations and individuals taking part in the study.)
- All participants and organisations taking part in this research will remain anonymous.
- Every aspect of the research process was scrutinised by the research team to ensure confidentiality every step of the way. (For example, all interviewees gave their consent to have their conversation recorded. The research team did its own transcriptions of the recordings, again to ensure confidentiality. There is no mention of the names of any of the organisations or interviewees in either the recordings or transcripts.)
- Any data collected will remain confidential to the Community Links research team; and destroyed after a reasonable period of time.

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- All data collected was stored in a single secure location, with restricted access.

- Throughout this report interviewees are referred to using the following codes:
- (Int. #) for the organisations' advisors and members of staff;
- (Cl. #) for the clients who have used the organisations' services.

Features of our sample

Communities

This study focused on communities, spread across the UK, which experience high levels of multiple deprivation, characterised by:

- high levels of unemployment and economic inactivity;
- low levels of skills and academic attainment (at least a quarter of those economically active have no academic qualifications);
- the public sector being one of the biggest employers, providing jobs for at least a third of the local population, especially in health and education;
- the private sector being made up mostly of micro- and small businesses;
- local residents sometimes being unwilling to work outside of their community, predominantly because of commuting times and travel costs, but, in some areas, on account of the limited working hours of the transportation system;
- ethnically diverse populations. There are two significant interrelated issues that are very often barriers to access to employment and the creation of businesses. First, a high proportion of people in these areas speak little or no English. Secondly, more than a third of the BME communities are not economically active. This figure is higher for BME females, especially from Asian backgrounds;
- an active informal economy. It is difficult to ascertain the level of informal economic activity. We asked staff within support organisations to estimate, and their average answer was between 15 per cent and 20 per cent of their clients (Int. 1, 3, 22, 23). Some of the staff interviewed acknowledged about a third of their 'start-ups' had been trading informally (Int. 20). For the two organisations running formalisation pilots the figure was obviously higher.

That is not to say that informal economic activities do not occur in other areas. In fact, research suggests that informal work is undertaken more prevalently by people living in more prosperous areas (European Commission, 2007). However, this study chose to focus on poor communities.

Organisations

Six of the organisations we studied were charities, two were social enterprises and two were private companies. Despite this, there were no marked differences in the way these organisations designed and implemented their formalisation interventions. All appeared to share a remarkably similar ethos and set of values. The sample can be characterised as:

Government-funded employment support organisations

Three organisations in our sample offered employment services within the government's welfare-to-work framework. They were contracted by the Department for Work and Pensions (DWP) to deliver various programmes of the New Deal – a mandatory service to get the long-term unemployed into apprenticeships, education or paid employment. One organisation's target population was young people (aged 18–24) not in employment, education or training (NEET), and another's was homeless people. As these organisations had to operate according to the requirements of the statutory funder, technically they had a contractual 'duty to disclose' if service users in receipt of benefits were also found to be receiving undeclared income from informal work or trading. All three organisations had found ways to circumvent these rules.

Case study: an employment support organisation (Organisation 4)

Organisation 4 was founded more than 30 years ago. It is a multi-services agency catering to families and children.

We looked at two of its programmes: one targeting young people (16–18 years old) and the other providing employment and business support to people aged 19–25 years.

The programme targeting young people was funded by the local authority and its aim was to support young people to get into education, training or paid employment (EET). Personal advisors supported the young people who were working informally to formalise their work. This was based on mutual trust, gained over time, and hands-on support and advice, again given over a period of time.

The employment and business support was delivered via a contract with DWP under the New Deal umbrella. The participants on this programme were referred by Jobcentre Plus. Experienced employment support and business advisors were able to read between the lines and identify those working and/or trading informally. They were given information on the advantages of formalisation and offered support to do so. The majority of those approached took up the offer. The vast majority that formalise tend to remain legitimate.

Business support organisations

Four organisations we interviewed offered business support as a core service. Mostly, this service was directed at business 'start-ups'. Three of these were funded through contracts which they delivered for local authorities, and the other was financed through the DWP's New Deal for the Self-Employed. For each of these organisations, their funding agencies determined the criteria for selecting service users. Two of the services funded by local authorities actually began as pilots which specifically targeted informal traders and helped them to formalise. Despite the success of these pilots they were not 'mainstreamed', and their funding was reallocated and directed towards 'more pressing' statutory obligations. The remaining two service providers found themselves working with informal traders as a result of providing business support more widely within their local communities.

Case study: a business support organisation (Organisation 1)

Organisation 1 was formed ten years ago to provide training, an employment service, business support and skills development to people with BME backgrounds in a local area. The founder, Mike, had been self-employed for 30 years and established the organisation when he realised that existing services did not empower local people to set up their businesses, nor help them to develop their assets. He secured an initial contract from a local Jobcentre, and today delivers business support contracts to a number of local authorities.

Mike keeps business costs down by drawing upon a diverse network of self-employed advisors, who deliver the organisation's programmes. These advisors come from a variety of ethnic groups, are multilingual and conduct various forms of outreach and community development work to find potential clients. Outreach work has built up a wide, informal network of stakeholders for the organisation. These include local churches, community leaders and local authority civil servants, as well as local residents themselves. This network, added to the diversity of the organisation's team, has meant that it is able to access areas and communities that 'conventional' business advisors could not normally reach.

The organisation's experience of working with small ethnic minority businesses and its working relationship with a local authority were central to it securing a three-year pilot project to formalise informal small traders. There were two aims to this initiative: a) try out and capture successful formalisation measures; and b) integrate small informal traders into the 'official' local economy. Although the emphasis of the pilot was not on outcomes, an internal evaluation showed that the initiative had resulted in the formalisation of a greater number of businesses than had been expected.

Micro-credit or finance support organisations

Two organisations we studied focused on micro-finance services: providing small personal loans up to £3,000 and business loans up to £5,000. The majority of loans these organisations granted were personal loans to clients who were reluctant to disclose their history of informal trading, and unable to access regular business loans.

Advisors we spoke to often cited lack of credit as a major factor contributing to informal trading, arguing that people starting a business can ill afford to formally register without it. These two organisations provided credit to individuals so as to finance their entrepreneurial endeavours. Neither of these organisations was established to distribute this credit, however. The core purpose of one of the organisations was to provide advice and 'signposting' for people who required business support. The second organisation's main activities focused on efforts to minimise credit defaults. In carrying out this work, the organisation's loan advisors – who were experienced in providing business support to formal businesses – offered credit to its customers when necessary. This practice was thus simply extended to its informal business clients as well.

Case study: a micro-finance organisation (Organisation 2)

Organisation 2 is a not-for-profit organisation which began 20 years ago by offering micro-loans to people who were considered to be 'un-bankable'. It has since expanded its services to better and more widely reflect the needs of the communities it serves. The organisation currently provides:

- business support;
- support for start-ups;
- small loans for small and medium-sized businesses; and
- a network for businesses that offer goods and services to customers in the city and region.

Funds available for lending used to be provided by the local regional development agencies, and borrowers from the organisation typically become medium- or long-term clients, securing many repeat loans. The organisation can provide low APR loans because repayment rates are high – the average rate being more than 80 per cent. The close relationship developed between the loan advisor and the borrower is, according to the business advisors, a strong contributing factor to this high repayment level.

The organisation also provides business support for local start-ups within certain postcode areas in their region, as part of a contract delivered for the local authority.

The organisation's various services, delivered across three geographic areas, bring it into contact with a range of client groups, including benefit claimants, the self-employed, owners of small and medium-sized businesses and people wanting to set up their own businesses. Where necessary, the organisation offers its services to clients who are 'hidden' but show an interest in formalising their businesses. In most cases such work was not openly disclosed to the organisation's funders.

Outreach activities are one of the main channels through which the organisation's business and loan advisors can develop a relationship of trust with their clients, in particular those who require formalisation services. This ensures that by the time the advisors begin a conversation about the particular needs of the residents and start to suggest ways to address them, there is already mutual respect and trust. This relationship proves highly valuable when advisors and clients discuss the client's informal business, and whether the entrepreneur is open to formalisation. Advisors stated that this openness is by no means uniform: some clients are more receptive than others to the message of formalisation, and the process is very different for every person.

Sample organisation's funding arrangements

Most of the organisations we interviewed were supported by a mix of funding from various sources. The main funders included the DWP, local authorities, regional development agencies, the Learning and Skills Council, and various European institutions (European Social Fund (ESF), European Regional Development Fund (ERDF), EQUAL). At the time of the research it was unclear what the precise impact of public-spending cuts would be on their services; however, as the majority relied heavily on public funding, it was predicted that this impact would be significant.

Unintended services

Apart from the two pilot interventions, the organisations we studied did not specifically design and offer a formalisation service. Through their day-to-day work they tended to encounter people who were not complying with regulations and then help them to make a decision to either formalise their activities or make an informed decision to stop their informal work and pursue formal paid work.

Client case study 2: Simon, 52, hairdresser

Simon was employed in the local steel industry, but as a qualified hairdresser also worked informally, cutting the hair of work colleagues to supplement his wages. Following redundancy from the steel mill in 1997 he carried on cutting his ex-colleagues hair for a further twelve months, earning about £100 per week. He didn't declare this work or pay any taxes. He was in receipt of benefits, primarily Jobseekers Allowance, of approximately £120 per week gross (1998). Part of his work included moonlighting in a local barber's shop, which brought him to the attention of a DSS fraud team. In 1998 they referred him on to a local enterprise support organisation.

The organisation was supported, in part, by a government contract to create more businesses in the local area. They received £2,000 per business to do so. The organisation worked on a 15 per cent margin so actual costs were around £1,700. The organisation made a commitment to support clients for the life of their business; there was much contact in Simon's first two years of trading and they have continued to stay in touch with him since then.

Over a six-month period Simon was helped to formalise his business by:

- a business advisor who had real practical experience of running a business as well as empathy towards this particular client group (the long-term unemployed);
- a business support worker, who dealt with the practicalities, such as administration, management of the client bank account while test-trading and helping him to set up a bookkeeping system and manage the finances.

Simon spent 26 weeks test-trading (in full receipt of benefits) before leaving the benefit system and has had no benefit payments since 1998. He initially spent six months on the programme, generating income as a mobile hairdresser. During this period he identified suitable premises to rent from the local council so that he could open a barber's shop. The organisation sourced a £500 soft loan to help with the refurbishment and he was able to move into the shop, from which he is still trading.

Since becoming formal, Simon has been free of the benefit system, part of the tax system and has run a successful small business for over 14 years. He provides part-time employment for one other member of staff and offers a valued service in his local community. Today Simon earns about £50,000 per annum (gross), which supports him and his family.

Financial costs & returns of formalisation (Simon, 52, hairdresser)

Cost (item)	Annualised costs (£)	Notes
Benefits payments	£6,240	
Business support	£2,000	
Commercial loan	£500	Paid back with interest
Undeclared taxes	n/a	Below the personal tax threshold
Sub-total	£10,850	
Returns (item)	Annualised returns (£)	
Taxes (income tax)	£20,000	Approx. 40% of £50,000 income
Savings to the State by non-payment of benefits and tax credits	£6,240	
Sub-total	£29,200	
	TOTAL (£)	
Annualised costs – returns total	£18,350	
Returns TOTAL (aggregated over 14 years (lifetime of Simon's business))	£338,800	Aggregated income tax paid over 14 years approx. £210,000 Aggregated savings to the state by non-payments of benefits and tax credits over 14 years approx. £128,800

2 WHAT IS THE INFORMAL ECONOMY? PRACTICE AND POLICY

In this chapter we introduce the informal economy, looking specifically at self-employment and informal work, and go on to explore some of the reasons, both pros and cons, for operating in such a way.

The authors have attempted to develop a typology of informal paid work, which will aid policy-makers to identify appropriate policy responses. We then review the policy approaches taken by various European governments and examine the question of whether the tide is turning from deterrence and punishment towards enabling compliance.

Defining the informal economy

Informal work involves the paid production and sale of goods or services which are unregistered by, or hidden from the state for tax, benefit and/or labour law purposes, but which are legal in all other respects.

– European Commission, 1998

In this report we have adopted the most commonly used definition of informal work (EC, 1998; Small Business Council, 2004). Informal work involves the production and distribution of legal goods and services in which there is non-compliance with regulations in areas such as tax, conditions of employment, the claiming of benefits while working, health and safety, the minimum wage and registration (Becker, 2004; SBC, 2004; European Union 2007). Illegal, criminal activities such as drug dealing or prostitution have been excluded from this definition, as have exchanges of unpaid work.

Informal economic activities are known by many different names across the world, including underground, twilight, hidden, moonlighting, ghosts, unobserved, undeclared work, cash-in-hand work, grey economy, black market, illicit activities.

The size and scale of informal work in the UK

Informal economic activities are increasingly recognised as an important component of the UK's local and regional economies by scholars and policy-makers (Chen, 2005; Evans and Syrett, 2006; Williams, 2001). Such activities mirror the diversity of the formal economy – many different types of informal work and businesses exist across several sectors. This picture is as complex as it is diverse.

Evidence suggests that a considerable number of people participate in the UK's informal economy:

- The annual informal economy represents 12.3 per cent of GDP, or around £270 billion (Schneider and Enste, 2002; Schneider, 2011).
- HMRC has calculated the UK's 'tax gap' to be £32 billion, of which £4.2 billion (12 per cent) is estimated to be lost to the hidden economy (HMRC, 2012).
- There are an estimated 500,000 'ghosts' and 1.5 million 'moonlighters' operating in the hidden economy (HMRC, 2012). At least two million vulnerable workers are involved (TUC, 2008).
- About 20 per cent of people of working age have done some sort of informal work during the last year in areas where Community Links has conducted research (Community Links, 2006–2011).
- "I would say 15–20 per cent, something like that [are involved in the hidden economy], so it's quite a high" (Int. 3).
- A recent YouGov poll for The Royal Society for the encouragement of Arts, Manufactures and Commerce (RSA) found that 20 per cent of respondents said they had traded informally on at least one occasion when starting one of their businesses (Dellot, 2012).

Community Links' extensive research work has shown that informal economic activities have a complex and interrelated impact on people's lives. In the short term, informal work helps people deal with periods of dire poverty, triggered by illness or loss of a formal job, by enabling them to pay for necessities. In the medium term, however, informal work leaves individuals outside the formal labour market, unable to access rights such as the minimum wage and sick pay, and may keep them in poverty.

The current global economic crisis may have led to the growth of the informal economy. This analysis presupposes that the decline of one sphere leads to growth in the other; however evidence for this is thin (Williams, 2008). Indeed, evidence is emerging that the formal and informal economies operate in a complementary rather than substitutive manner. Both tend to grow and decline in tandem; when spending is short in one, it is also lacking in the other (Dzvinka, 2002; Williams and Windebank, 1998). At the macro level, this 'reinforcement thesis' holds that both spheres simultaneously grow or decline nationally or regionally (Dzvinka, 2002). At the micro level this relationship is illustrated with evidence that deprived households conduct less undeclared work than affluent households.

See Appendix 1 for more information about who is doing what in the informal economy.

Box 2: Community Links' measuring of the informal economy at Super Output Area level

In 2005/06 it became clear that qualitative evidence about informal work was insufficient for decision- and policy-makers. There are various macro-measurement methods (at a country level) being used, but very few which can measure the informal economy at a local, borough-wide level. So Community Links, with some academic partners, developed its own research methodology to measure the size and scale of local informal economies at Super Output Area (SOA) level. We undertake street-based intercept surveys with local residents. We also recruit and train local people to collect the data (this helps build trust and increases the likelihood of disclosure).

We have conducted four measurements to date (2006–2011): at three locations in London, and one in the north of England. In these areas we found that approx. 20 per cent of people of working age had done some sort of informal work during the last year.

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Self-employment and informal work

There are misconceptions about self-employed people operating informally. It is hardly uncommon to get two quotes from a garage or painter and decorator, with the lower quote dependent on payment by cash. There can be a complicit assumption between both parties that VAT will not be paid.

The few studies on the subject, however, indicate a more nuanced reality (Community Links, 2006–11; European Union, 2007; Williams, 2004b). Interception surveys conducted by Community Links in several local authorities in England showed that around 12.5 per cent of those who disclosed their cash-in-hand work in the previous year also defined themselves as self-employed. This proportion of self-employed people operating in the informal economy mirrors the number of self-employed people in the UK's formal economy (ONS, 2011).

Reasons for working cash-in-hand: the pros and cons

“Many people see a business as a way of getting out of poverty. They have no bank support and they start up in a little place. They ask advice from friends and just go for it. The big problem is that their livelihood is dependent on benefits. They are not financially prepared to start their business in a formalised way. They love to try in life. They do this and hide it. Everything goes informal from there because they may face consequences, fines, etc., in the future, because of the way they started to trade. They have

a market in their communities. However, they cannot get out of their communities, they lack confidence. They can't go openly, they cannot grow. Their position is that informality does not allow you to go openly. It is a vicious circle.”

(Int. 11)

The key to effective policy-making is for it to be based upon real understanding of why people work informally. The focus is too often on the negative aspects of informal paid work: non-payment of taxes and about those who are claiming welfare benefits and not declaring their informal work. There are risks concerning informal workers themselves: of exploitation, a lack of legal protection and a greater risk of injuries, but these feature less in policy-making. In addition to this, however, are significant risks to the consumers of the goods and services in the informal economy: the lack of recourse for substandard work and limited product guarantees (Gallin, 2001; Williams, 2005a).

The negative aspects of informal work are only half of the picture, as outlined in Table 1 below. Community Links' research has shown that informal work can have a positive role in the workers' lives. Economically, the main benefit to people working informally is that they are provided with an income, keeping them from poverty. In addition to this, informal work can develop their confidence, increase their skills and help in building up their social capital (Copisarow and Barbour, 2004; Travers, 2001). All of these effects help sustain their income and increase informal entrepreneurs' chances of creating successful, formal businesses. It should be noted that Table 1 is not a comprehensive list.

The key to effective policy-making is for it to be based upon real understanding of why people work informally.

Table 1: Negative and positive aspects of the informal economy

Negative aspects	Positive aspects
... for informal workers or traders	
Lack of access to credit and financial services, partly due to limited credit history.	A source of income to stay out of poverty.
No entitlement to labour rights such as minimum wage, sick pay, working hours directives or redundancy rights.	Improvement and development of an entrepreneurial spirit and skills that could be transferred to the formal economy.
Difficulty in expanding a business which cannot be openly advertised.	Flexibility in where, when and how to work and trade (especially important for women, who undertake the majority of child-rearing activity).
May face higher barriers of entry to the formal market on account of an inability to provide employment history to back up their skills.	Reduced barriers to entry into employment and trading, because the majority of informal work starts with family and friends.
... for the customers of informal workers and traders	
Contractual arrangements between consumers and informal traders may be limited or non-existent; legal rights may not be upheld.	A more affordable product or service can be offered to or asked for by customers if payment is made in cash and no receipts change hands for tax avoidance purposes.

(continued overleaf)

Table 1 (continued)

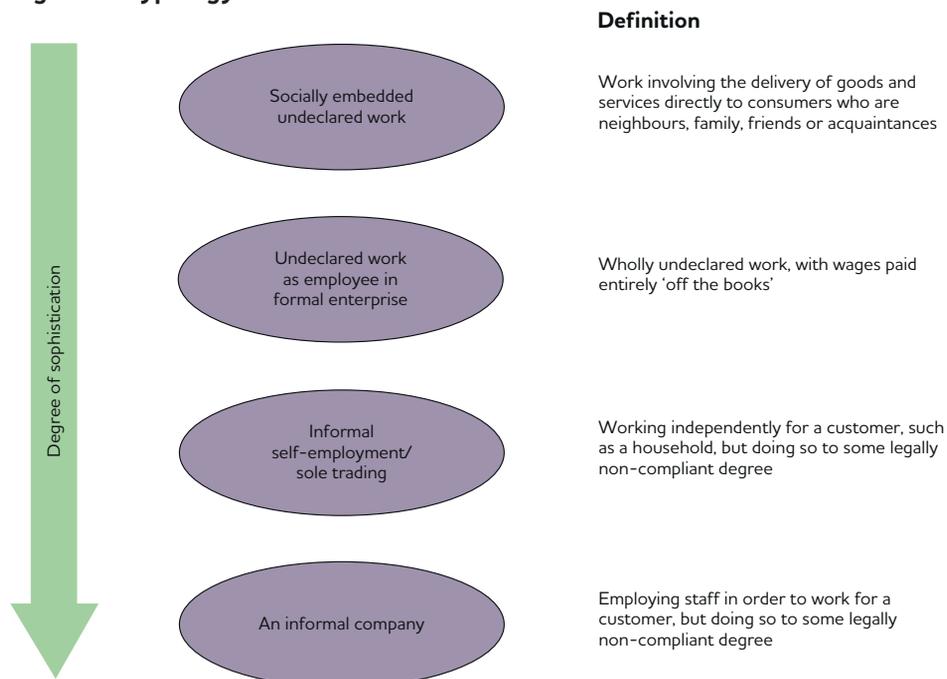
... for society more broadly	
Tax avoidance and benefit fraud result in lost revenue and unnecessary spending. This may mean that public funding for other social and economic programmes may be reduced.	Training of workers and entrepreneurs 'on the job' does not require a visible outlay of financial resources, which may alleviate some of the pressure on the state and its agencies during times of reduced public spending.
Loss of regulatory control over the quality of products and services produced and distributed.	Paid favours are exchanged for mutual benefit between friends, relatives and colleagues – sharing the wealth and building social capital.
Wage and cost competition with informal businesses may result in the weakening of employment rights for all workers and downward pressure on the minimum wage.	Income generated through the informal economy is spent in the formal economy, contributing to 'official' economic growth. Informally earned income boosts the demand of formally produced and distributed goods and services.
Inaccurate employment and earnings statistics which omit informal workers may adversely affect employment and business support policies implemented by local and national governments.	

Sources: Community Links (2011); Copisarow & Barbour (2004); Travers (2001); Williams (2005a)

Types of informality

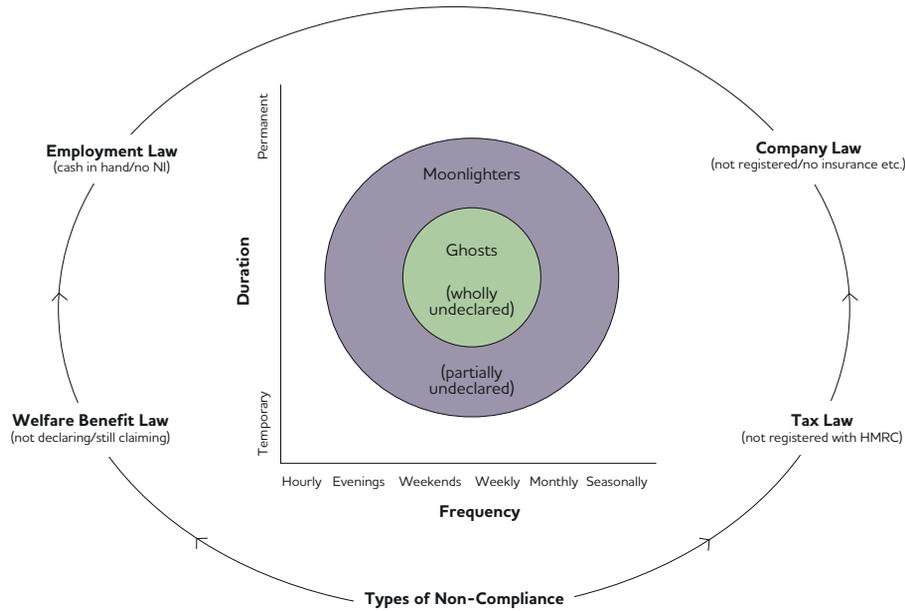
The heterogeneous nature of the informal economy means that developing a typology of informal work is challenging. However, some form of typology may be required in order to identify appropriate policy responses, so a possible outline is presented here in Figure 2.

Figure 2: Typology of informal work



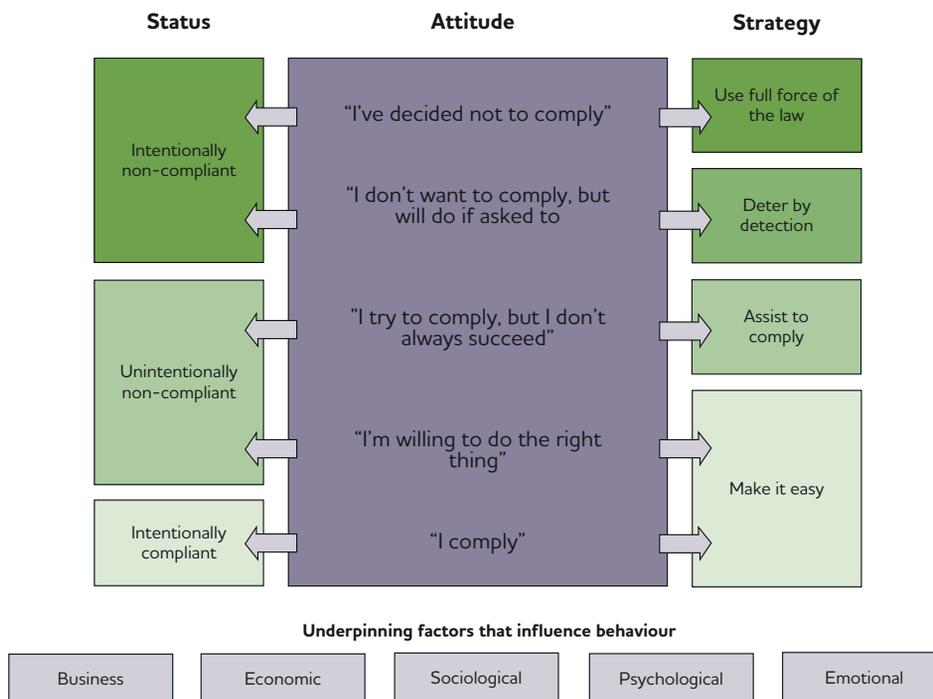
Source: Adapted from Williams (2008)

Figure 3: Levels of informality



In addition to classifying the broad types of informal work that individuals are likely to engage in (see Table 1) there are two further ways in which we can refine a typology of informal work. First, we can consider the degree of informality of individuals' working behaviour: are they only partially unregistered, for example, or are they completely registered but their company employs cash-in-hand workers? Figure 3 breaks down these distinctions in greater detail – though complex, this diagram should be read from the centre outwards. It attempts to capture four interdependent aspects of informality.

Figure 4: Understanding compliance



Source: adapted from the Australian tax model cited in Deloit (2012)

On the other hand, we could consider the **intentions** of those who engaged in informal economic activities, and their attitudes towards compliance, as distinguishing features of the 'type' of informal worker they are. Figure 4 demonstrates one way of creating a typology based on these characteristics.

Working towards a typology will help policy-makers understand both the variety of undeclared work undertaken and also people's attitudes to undeclared work and compliance. This will aid subsequent development of an appropriate mix of policy responses. Some of these are highlighted in the next section.

Policy context

The government is in a bind when addressing the UK's informal economy. On the one hand it has to recognise the very existence of the informal economy, but in doing so, and by implication, it must then take action to address it. If they do not pursue a 'crackdown' policy they will be seen to condone it – a classic 'catch-22'. Successive governments in this country have attempted to tackle the informal economy through a raft of initiatives and inquiries, but in the authors' view have achieved little (a recent and significant watershed being the Grabiner report on the informal economy published in 2000). As the RSA's Matthew Taylor wrote:

[R]educing the informal economy is a classic example of what some analysts call a wicked problem. It has many causes, multiple stakeholders, and is unlikely ever to be 'solved'. Moreover any solution involves that hardest of policy tasks: changing social norms ...
– Taylor (2012)

The informal economy's diversity and inherent complexities – structural, hierarchical, moral, legal, socio-economic and cultural issues – are all at stake. There is no simple (or singular) black-and-white solution to the grey economy. The piecemeal policy approaches adopted by successive governments do not fit neatly into a 'one-size-fits-all' response, but rather require a more nuanced understanding of people's (and companies') motivations and intentions, and then a menu of interventions that can be tailored to meet their needs. The following section attempts to unpick the policy approaches taken by governments across the EU and asks whether the tide is turning towards adopting more enabling approaches to compliance and the informal economy.

The informal economy and government policy

The informal economy interacts with government policy in several areas, including:

Non-payment of tax

Some people involved in the informal economy do so in order to avoid paying tax, for whatever reason (e.g. not registered with HMRC, registered but under-declaring on tax return). The consequence of this is that there is less money available to pay for public services. In the UK, for example, the official estimate of the tax gap caused by the hidden economy is £4.2bn (HMRC, 2012).

Benefit fraud

Working informally while also claiming benefits often constitutes benefit fraud, since work done while an individual receives benefits must usually be declared. In the UK there are no official estimates of the benefits cost of informal working. However, DWP estimates that total benefit overpayments as a result of fraud are £1.2 billion, or 0.8 per cent of total annual spending on benefits (DWP, 2012). Clearly this adds to the cost of the benefits system.

Unemployment and economic inactivity

Community Links' research suggests that unemployment figures do not tell the whole story, since some of those classed as unemployed may actually be working informally. This indicates that government policies operate under false assumptions, and may well be inadequate or poorly designed to meet the real challenges of returning the 'unemployed' to formal work. Official estimates in the UK are that there are currently 2.56 million people unemployed (ONS, 2012).

Workers' rights and regulations

Enforcement of health and safety and minimum wage regulations is particularly hard in the informal economy, leaving workers potentially exploited (e.g. no employment contract, paying cash in hand and below the minimum wage, not paying national insurance contributions). The TUC's 2008 Commission on Vulnerable Employment estimated that there were over two million vulnerable workers in the UK.

Strategies to deal with the informal economy

There are a number of different policy approaches taken by governments.

Laissez-faire

The ideology of laissez-faire is a policy option applied to the informal economy, more often than not by default. The rationale is that informal entrepreneurship represents a seedbed for new enterprise creation, a breeding ground for the micro-enterprise system and a test bed for fledgling businesses and should therefore be left alone. The problem with this approach is that informal entrepreneurship has negative impacts on formal businesses, those working informally, customers and governments (Evans and Syrett, 2006; Gallin, 2001; Grabiner, 2000; Renooy *et al.*, 2004; Williams and Windebank, 1998), which means that doing nothing requires interventions to tackle informal entrepreneurship.

Deterrence

Deterrence is a negative reinforcement approach, which seeks to elicit a change in behaviour by using a 'stick' to deter and punish those who do not comply with tax, benefit or labour laws. Governments typically execute this strategy by increasing the risks and costs associated with informal work.

First, this is done by raising the likelihood of detection through improvements in the co-ordination of strategy, operations and data-sharing across relevant government departments and agencies. Secondly, penalties associated with informal working are increased. In addition to increasing the likelihood of detection and actual cost, governments attempt to increase the **perception** of risk through publicising high penalty levels and advertising the effectiveness of detection procedures.

Enabling compliance

In recent years there have been calls for a more enabling approach towards undeclared work (Hite, 1989; Renooy *et al.*, 2004; SBC, 2004; Williams, 2006). This approach seeks to change behaviour by encouraging compliance. It is grounded in the belief that negative reinforcement is ineffective compared to the positive reinforcement of good behaviour. In tackling the informal economy, some European governments have taken a positive reinforcement approach, which has taken at least three different forms:

- **Preventative measures** have been adopted in order to intervene early and avoid the development of informal working practices. Such measures include: simplifying regulatory compliance; introducing new categories of legitimate work, enabling those involved in undeclared work, often by necessity, to move into the declared realm (Germany created a 'mini-job' category of employment which encourages people to legitimise these small jobs); providing better business support and advice; direct and indirect tax incentives to encourage formal start-ups; and developing initiatives to ensure a smoother transition from unemployment into self-employment.
- **Curative measures** or incentives have been used to help transfer already active informal entrepreneurs and workers into the formal economy. These measures include: offering society-wide amnesties and/or individual-focused amnesties to those who are willing to put their affairs in order; offering business advice and support to those seeking to formalise; and providing a range of direct or indirect tax incentives in order to encourage the customers of informal businesses to use formal alternatives.
- **Commitment measures** have been adopted, which encourage long-term commitment to 'good' behaviour as individuals and as a society. This requires commitment to the measures above, and stability in these policy commitments over the medium-to-long term. In addition to this, successful commitment measures rely on tax and business education as low tax morality leads to higher levels of undeclared work (Richardson, 2006).

Campaigns can be run to inform undeclared workers of the costs and risks involved in such work, as well as sell the benefits of moving into formal work; and inform potential users of undeclared labour of the risks and costs, as well as of the benefits of formal labour.

Peer surveillance may also prove an important mechanism for ensuring commitment to formal work. For this to be effective there must be an overall high degree of tax morality in the population in general. Thus, there is a case to be made for positive publicity campaigns on the benefits of declared work, in conjunction with telephone support lines.

Finally, a crucial commitment measure to formal business practices, and one that has a significant impact on tax morality and compliance (Wenzel, 2002), is the perception that the tax system is fair and just: fair in that individuals believe that they are paying their fair share of tax compared with others; and just in that people receive the goods and services they believe they deserve, given the taxes they pay. This principle of redistributive justice needs to be upheld in individuals' and businesses' interactions with the state, thus enabling committed compliance.

Table 2 summarises the main types of policy approaches taken by governments around the globe.

Table 2: Policy approaches taken by governments

Approach	Method	Measures (examples)
Deterrence (pursue and punish)	Improved detection	Data matching and sharing
		Joined-up strategy
	Increased penalties	Joint operations
		Increasing penalties for evasion
Increased perception of risk	Advertising the penalties for informal working	
	Advertising the effectiveness of detection procedures.	
Enabling compliance	Prevention (deter entry)	Simplifying compliance
		Direct and indirect tax incentives
		Smooth transition to self-employment
		Introducing new categories of work
	Curative (encourage out)	Micro-enterprise development
		Demand-side incentives (e.g. service vouchers, targeted direct taxes, targeted indirect taxes)
		Supply-side incentives (e.g. society-wide amnesties, voluntary disclosure, formalisation services)
Fostering commitment (retain in the formal economy)	Promoting benefits of formal work	
	Education	
	Peer-to-peer surveillance	
	Tax fairness	
	Procedural justice	
		Redistributive justice

Source: Williams (2009)

Box 3: Morality and the informal economy

Though this study did not investigate the morality of the informal economy it is important to briefly touch upon it.

Superficially it might seem obvious that the underground economy cannot be morally justifiable. It is after all illegal, unreported, unrecorded and informal (Priest, 1994). People are circumventing the rules and regulations, concealing their 'immoral' activities. In doing so they are in

some way impeding legitimate government activities and increasing the tax burden on compliant citizens (so there are fairness arguments at play here), as well as undermining the broader values about what it is to be a responsible citizen (Feige, 1990).

The year 2012 saw senior politicians, such as the Treasury's David Gauke, question the morality of customers paying tradesmen cash in hand, followed by the ensuing embarrassment when Cabinet members admitted paying cash in hand on occasions. A *Daily Telegraph* poll (24 July 2012) showed that more than 76 per cent (n=22,305) of the general public have paid their tradesmen cash in hand and see nothing wrong with it. (There is no law against paying someone in cash, but a business is under a legal obligation to disclose earnings to HMRC and say whether it is liable for income tax or VAT.) Which raises the question: why? Participants in the informal economy may be breaking legal norms, but are they breaking social norms? At what point down the moral spectrum does informal work change from being acceptable (where people are earning a little extra on the side) to unacceptable levels of exploitation, fraud or even death (such as happened in the case of the Morecambe Bay cockle-pickers disaster, where gangmasters contributed to the deaths of 21 Chinese immigrant workers, and which resulted in the establishment of the Gangmasters Licensing Authority)?

Since the 2008 economic crash there has been a rise of campaigning groups, such as UK Uncut and the Tax Justice Network, challenging the culture of tax havens and other avoidance measures used by large corporations. The Public Accounts Committee (July 2012) and media have played their role in uncovering the use of off-payroll tax avoidance schemes by BBC journalists, senior business executives, comedians and pop stars. The Chancellor of the Exchequer, George Osborne, in his March 2012 Budget statement, questioned the tax morality of certain corporations: "I regard tax evasion and – indeed – aggressive tax avoidance – as morally repugnant". All of which provoke wider questions about the role of tax morality and public services, legitimacy of state expenditures, the (fair) burden of tax and regulation regimes, and social inequalities.

So the challenge is to consider the wider (and at times, positive) value of the hidden economy, as we noted in Table 1, above. For example, a study carried out by Dr F. Schneider in Germany found that about two thirds of money made in the shadow economy is spent in the official economy, and more than two-thirds of the services offered on the black market would disappear if they were forced to go overground. The morality of the informal economy must be fully understood by grappling with its diversity and inherent complexities, which can (briefly) be summed up by a number of schools of thought (Dellot, 2012; Williams, 2009):

- The dualist school sees informal activities emerging when there are too few employment opportunities in the formal sphere and when those that do exist are inappropriate for individuals seeking employment, in part because of a mismatch in skills. The excess labour that is not accommodated in the formal economy is soaked up by the informal economy.

- The structuralist school argues that informal activity exists to serve the needs of larger firms by supplying cheaper goods and services. This view seeks to highlight the plight of informal workers as marginalised and exploited individuals.
- The legalist school suggests that informal activity represents the overflow of entrepreneurialism that is stifled in the formal sphere due to cumbersome regulation and bureaucracy. The school's main proponent, Hernando de Soto, argues that formality, not informality, is the problem that needs to be addressed.
- The voluntarist school considers informality to be the result of a simple cost-benefit decision on the part of informal workers. Where the benefits of informality (for example, the avoidance of taxation and regulation) exceed the probability and cost of getting caught, entrepreneurs will seek to remain below the radar.

Moral judgements play a part in all of these schools. The morality of the hidden economy must be taken into account by policy-makers as they seek to change wider behaviour by designing comprehensive solutions. However, as already stated, this research report did not examine morality, so we will go no further than to say that more research is needed to unpick the thorny, ethical issues that inevitably arise from this subject.

Governments' approaches to their informal economies in practice

Our literature review has indicated that the majority of European countries, including the UK, have adopted deterrence as their preferred policy response to the informal economy, with some variations in the way it is implemented. The catch-22 for government is that it has to wrestle with the problem of informal work but cannot be seen to condone or endorse it; and yet punitive approaches tend not to be as effective as those which aim to enable compliance.

Analysis of the history of European states' informal economy policies shows two clear, common trends. Firstly, in the 1990s, there was a general move by the majority of EU member states to implement punitive policies that sought to deter undeclared work. The second clear trend is that these strategies have not led to the intended reduction in the size of the informal economy in these states. In fact, in 2007, an EU Commission study indicated that rather than decreasing, informal economic activities are actually on the rise (European Commission, 2007).

This punitive approach towards informal working reflects traditional methods of dealing with crime. However, it seems ill-fitted to this policy area and has little effect in reducing either benefit fraud or the tax gap (Hessing *et al.*, 1993). Not only has this singular approach manifestly not succeeded in eradicating informal economic activities, deterrence strategies can lead to perverse incentives for those active in the hidden economy, pushing often vulnerable people into further dependence on informal work. In the UK, the DWP has recognised that 'hardship is an important factor motivating people to commit [benefit] fraud' (DWP, 2012), yet by treating informal work solely in terms of benefit fraud, rather than recognising that it is a strategy used to escape poverty, governments often make it harder for people to exit the hidden economy and find a lasting solution to their economic needs.

By enabling or encouraging people to 'formalise' their economic activities, government can deal more effectively with both the underlying cause (poverty) and its symptom (informal work).

The 2007 Eurobarometer research found that not only do policy-makers still generally prefer a deterrence approach, they remain convinced that it is the most effective method of tackling informal working. This assessment is uniformly held across all EU regions except for the Nordic nations, where policy-makers ranked commitment measures as their top priority. Despite this difference, there is little systematic evaluation of the effectiveness of the policies that reflect these different priorities, and insufficient sharing of good practice between countries.

Compounding the problem with the approach taken by government is the complexity of the policy challenge due to the heterogeneous nature of the informal economy. The policy implications of the informal economy span many government departments, and synthesising a 'joined-up' approach across diverse departmental aims and cultures has proved highly challenging.

In recent years in the UK, for example, governments' response to the informal economy has been marked by such an absence of a consistent, cross-departmental, strategic approach. Principal departments such as Business, Innovation & Skills (BIS), DWP and HMRC have different priorities in addressing their specific areas of interest in the informal economy (e.g. HMRC and non-payment of taxes), and thus take different approaches which generate disparate, and at times counterproductive, results.

Common to all, however, has been a predilection for deterrence and punitive action, and reluctance to engage in compliance-enabling policy-making. Table 3 below outlines the UK's key departmental players, and the important elements of their strategy for each of the four areas in which the informal economy interacts with policy. We have deliberately left out the Home Office, the UK Border Agency (UKBA), the police and other agencies that tackle forced labour, human trafficking and illegal labour practices, as they fall outside the scope of this research.

The key point at which the UK government signalled this emphasis on deterring and punishing informal work came in 2000. Lord Grabiner, on behalf of the Chancellor of the Exchequer, conducted a review and presented proposals on how to deal with people engaged in informal work (Grabiner, 2000). He recommended a mixed-approach using the 'carrot' and 'stick', which would on the one hand punish those who did not formalise and on the other would help those who did wish to formalise their economic activities. The government policy which followed the report, however, largely focused on the 'stick' element, remaining broadly continuous with the traditional approach.

It can be argued that certain, albeit isolated, policies adopted by government in the UK fall into an 'enabling compliance' rather than a 'deterrence' category. In 2008, the National Audit Office (NAO) undertook a study of all of HMRC's responses to informal economic activity. This suggested that these compliance-enabling approaches were more effective than efforts to deter individuals from working informally. NAO calculated that HMRC achieved an overall return of around 4.5:1 (for every pound spent, £4.50 was saved or generated) on the £41 million a year it spent on all of its hidden economy work in 2006–07. Positive advertising campaigns, which represented £2 million of the £41 million, resulted in some 8,300 additional people registering to pay tax, bringing in an estimated £38 million over three years, which provided a return on investment ratio of 19:1. See Table 4 below for more details.

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Table 3: UK policy measures

Policy area	Key government department(s)	Strategy used/policy measure taken
Non-payment of taxes	HMRC, Treasury	<p>The Central Compliance Department within HMRC, which includes a 'hidden economy' team. They also offer a telephone hotline, data matching with other departments and advertising campaigns.</p> <p>HMRC also provide local business education and support teams to support people setting up in business; and the Business Payment Support Service, which supports people who are experiencing difficulties paying the tax due.</p>
Benefit fraud	DWP	<p>The National Benefits Fraud Hotline, General Matching Service, local compliance and fraud teams, 'more frequent attendance' powers (to ask customers to several meetings at different times to disrupt their suspected informal work), data matching and advertising campaigns.</p> <p>The introduction of Universal Credit is intended to reduce the need for informal working by removing policies which currently act as disincentives to people who might otherwise take up formal jobs.</p>
Unemployment	DWP, BIS, HMRC, Treasury	<p>DWP is currently developing 'Universal Credit' to overhaul the current benefit system, and has introduced the Work Programme to support the long-term unemployed back into work, a number of whom will already be working informally and need assistance to either formalise their activity or transfer into formal employment.</p> <p>Business Links is a national service supporting businesses to start-up and grow. Local Enterprise Partnerships (LEPs) support the economic development of local areas in the UK.</p>
Workers' rights	DWP, HMRC, Defra	<p>There are currently four enforcement agencies, managed by different government departments, which have responsibility for safeguarding workers' rights: the non-departmental Health and Safety Executive, HMRC's National Minimum Wage Compliance Unit, BIS's Employment Agency Standards Inspectorate and Defra's Gangmasters Licensing Authority, plus the Employment Tribunals.</p>

Table 4: Cost–benefit analysis: HMRC approaches to the informal economy

Method	Measure	Return/cost ratio
Deterrence	All detection measures	5:1
	Tax evasion hotline	2:1
Preventive	n/a	n/a
Curative	VAT amnesty	23:1
Commitment	Advertising campaigns	19:1

Sources: NAO (2008); Williams (2012)

Government in the UK still appears reluctant to develop a detailed and nuanced study of the nature of the UK's informal economy. This lack of evidence is a principle cause of governments' inability to design appropriate and cohesive policy responses. This limited understanding of the problem is highlighted, for example, in the Local Democracy, Economic Development and Construction Bill (2009), which instils a statutory duty on local authorities to conduct a local economic assessment, but does not make the informal economy a necessary part of this assessment. This makes little sense as Community Links' own local measurement work suggests that in some areas about 20 per cent of the working-age population has done some sort of cash-in-hand work over the last year (Community Links, 2006–2011).

Not only is there a lack of understanding at the centre of government, but regional policy-making is similarly hampered by poor understanding of the issues, limiting the practical action taken. Not one of the nine (now abolished) Regional Development Agencies carried out any significant studies of the informal economy. There is also scant information among the UK's 500 local authorities about their local informal economies. Levels of knowledge and policy appear to vary dramatically: from no understanding, to commonly held misconceptions and assumptions about benefit scroungers and cash-in-hand work, through to fairly detailed knowledge about what is going on in their local area and with a developed policy.

One thing that is clear, whether in the UK or wider EU, at national or regional level, is that good practice in policy-making on the informal economy is not simply about choosing individual policy measures that are effective at tackling undeclared work. It is also about considering the most effective way in which these different policies can be combined (Williams and Renooy, 2008). Evaluating which sequences of measures are effective and transferable should be, but sadly is not, an integral part of the review process for any government trying to address their informal economy.

European governments' policy responses to the informal economy: is the tide turning?

Although our literature review has indicated that the default policy position on the informal economy for governments in Europe is to attempt to deter entrance and punish involvement, in recent years several EU member states have considered harnessing the potential of informal work. Some have shifted from deterrence alone towards combining deterrence, preventative and curative measures since Employment Policy Guideline No. 9 was issued by the EU Commission in 2003. Germany and Belgium, for example, have both initiated programmes to draw people out of the informal economy (Renooy, 2007).

The Belgian initiative, introduced in 2005, seeks to transform 'latent demand for a whole range of goods and services into paid employment' (Renooy, 2007). It attempts to do this through the sale of government-subsidised, and partially tax-deductible, vouchers for personal services such as house cleaning, washing and ironing, sewing, running errands and preparing meals. These vouchers can be spent with certified companies who can hire unemployed people and gradually move them on to long-term employment contracts. By the end of 2005, 200,000 households had used vouchers to pay for services, 75 per cent of which were in house cleaning. By the end of 2005, through this scheme, the equivalent of 17,360 full-time jobs (28,933 people) had been created, of which up to 25 per cent have been estimated to have been created from previously undeclared work.

In 2003, the German government introduced three 'minor job' types, in which employees are exempt from standard social security payments. These jobs can be worked alongside normal employment, or while receiving certain entitlements such as pensions, unemployment benefits or a family health scheme. The job types are:

- 'Mini-jobs' with a €400 income limit, in which employers are liable for reduced social security contributions of 23 per cent.
- Mini-jobs in the household sector, for which the employer has to pay a levy of 12 per cent and can deduct a proportion of the payment from tax.
- 'Midi-jobs' paying between €400 and €800, incorporating a tapered rise in employee social security contributions from 4 per cent up to the full 21 per cent.

By the end of April 2003, there had been an initial rise of 1.36 million people in minor employment. The vast majority of these people (1.21 million) made use of the ability to combine minor with normal employment, of whom it appears likely that around 580,000 transformed a previously undeclared add-on job into registered minor employment. From these 1.21 million people, 463,000 used their mini-jobs in combination with partial receipt of unemployment benefits.

Initial evaluations of these two schemes indicated that they were achieving their objectives: individuals and businesses that were operating wholly or partially at the margins of legitimacy had moved into the mainstream economy. Renooy (2007) has argued, however, that this transfer from informal into formal employment has been relatively slow, given the estimated levels of undeclared work.

Box 4: Hidden economy knowledge bank

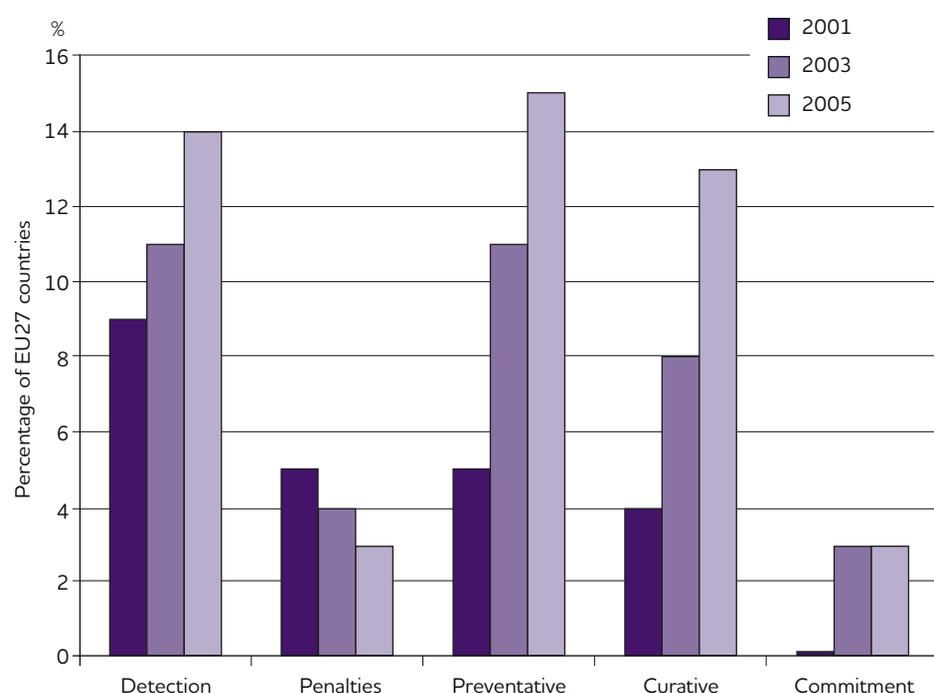
Over 100 initiatives and case studies can be found at the EuroFound 'Hidden Economy' Knowledge Bank. Descriptions are given of the different approaches taken by EU member states in addressing their informal economies, and the effectiveness of specific policy measures and their transferability is examined.

Source: www.eurofound.europa.eu/areas/labourmarket/tackling/search.php

Beyond these isolated examples, there is some evidence that a wider change is under way – moving from deterrence strategies alone towards more complete, compliance-enabling approaches (see Figure 5). This has, to some degree, been reflected in UK governments' policy-making. Behind

the scenes over the final three years of the last Labour government, policy-makers and ministers showed greater willingness to look at the nuances of informal work and address it with an integrated approach. In 2009, Treasury Minister Stephen Timms MP announced in the Pre-Budget Report 2009 that HMRC would establish and co-ordinate the Hidden Economy Advisory Group, and report in time to feed into the 2010 Budget. This group was made up of civil servants, scholars and practitioners, including Community Links, and looked at the extent and characteristics of the hidden economy, and made policy recommendations. This work was never made public as the General Election put a hold on it.

Figure 5: Distribution of policy approaches taken by EU countries, 2001–5



Source: Williams et al. (2008)

The Coalition Government has yet to reconvene the previous government’s group; however there are some signs that this direction of travel is set to continue, particularly within DWP and HMRC. The DWP’s *21st Century Welfare* consultation paper, published in July 2010, includes this promising paragraph:

As a result [of the complex benefits system] working legitimately is not a rational choice for many poor people to make. Fraud is always wrong, but we must recognise that the benefits system is making matters worse by pushing valuable work, and the aspiration that this can engender, underground.

The new Universal Credit system could help to make sufficient systemic change, as it will remove the disincentives to work that are currently found in the benefit system. These perverse incentives trap people on benefits and force them to seek alternative, informal methods to ‘get by’.

HMRC has commissioned research to measure the size and scale of the informal economy and to assess people’s intentions and motivations for

working informally. It is refreshing that the strategy for dealing with the UK's informal economy is recognising that a 'one-size-fits-all' approach has little effect.

Although there are opportunities there are also a number of factors prohibiting this continued direction of travel. These include a lack of co-ordinated and strategic activities between government departments to understand and harness the UK's hidden economy.

The financial cuts by the Coalition Government are having an impact on the supply of public services which might help people in business; for example, the significant reduction in funding for the business start-up and support programmes initiated by the last government, and from the DWP. However, there has also been a withdrawal of funding from the EU funds European Social Fund and European Regional Development Fund, and from economic regeneration programmes like Single Regeneration Budget and Neighbourhood Renewal Fund. It is well publicised that the banks are also lending less to small businesses. What is available is small scale, targeted at specific groups, and tends to be delivered in a traditional way (focus on the theory of business, learnt in a classroom, formulaic in its delivery and requiring a certain level of formal education) – in other words, not suited to the typical needs of, say, an informal entrepreneur wishing to formalise her business.

Business Links now only provides a telephone and web-based service, all face-to-face support has been withdrawn. The Regional Development Agencies and their funding for regional growth and business support have disappeared. The Regional Growth Fund is two-thirds less than was spent through the Regional Development Agencies: £500m in contrast to £1.5bn (BIS, 2011). It is early days for Local Enterprise Partnerships. They will vary enormously in their success depending on who and how they are run in each locality. It is our view that the Government needs to do more to address the UK's informal economy. The formalisation model we suggest later in the report and policy recommendations at the end may go some way to contribute to the growth of the UK's economy.

Client case study 3: Thomas, independent taxi driver

Thomas is in his late 40s. He currently works as an independent taxi driver and is paid cash in hand. Thomas suffers from a chronic illness, culminating in sporadic debilitating episodes every five years or so. The recovery from these episodes can take up to two years. During this time he is not able to work. As a result of this, Thomas has found it very hard to hold down a regular job throughout his life. He lost his last formal job seven years ago after one of those episodes.

After this, and due to concerns about his employability, he decided to start his own gardening business. He started small, cutting grass and hedges for friends and neighbours. This rapidly expanded to a point at which he took a loan from a micro-lending organisation to invest in proper tools and equipment. As Thomas' health improved he was able to take on more customers by advertising through the local community. However, he still continued to claim incapacity benefit. This increasingly worried him:

"I was doing it on the fiddle. I did not know what I was doing, at the same time I was on incapacity benefits. At the time when I started there was a campaign against benefit fraud, I was

completely scared. You are scared of anybody. It is constantly in the back of your mind. It consumes your life. It does your head in.”

Having traded informally for about seven months, Thomas went to speak to his loan advisor about how to begin to “declare taxes and everything”. They helped him immensely. Thomas, says that “the stupid thing was, with the benefit I was on, if I had declared it, I would have been allowed to earn about £60 a week. I would have been OK. I would have been legit. It was six months of worry for nothing. I went to the benefits office and he said that it was not his job to tell us those things. However, I felt relieved. I went to see the tax office and settled it and it was not a problem.”

After Thomas was registered, he went to a high-street bank to open a business account. Again, Thomas says, he was naively talked into buying products such as a computer and printer by the bank advisor: “I could not argue, they are the bank, they are recommending it”.

Soon, Thomas’s business started to drop off. He talked to the bank about his cash-flow problem and showed them his books. The bank advisor decided to close Thomas’s bank account and sent him to talk to a doorstep lending institution to consolidate his debts. “I refused to do it because the interest was outrageous. The bank closed my account and started sending me threatening letters ... I knew I could not afford a period of grace. I was against the wall.”

Thomas then changed tack and went back to talk to his micro-lending organisation. “They asked me to get a guarantor and the organisation approved a loan to pay the bank and my business. I was running again with my landscape business. I took on a couple of mates to work cash in hand. I used them as and when I needed them. After a while I had to stop because of my recurring illness and the loss of my van.”

After this renewed bout of illness and some domestic problems, Thomas found himself needing to find a new source of income. He decided to become a self-employed taxi driver, and continued to claim Jobseeker’s Allowance benefits alongside. He got a loan from a micro-lending organisation to buy a car and is slowly building his business, which he plans to register soon. He says: “One can think one is clever, but you can’t get away with anything. You can fiddle it and dodge it for a time, but they are clever, so it is better if you do it above board. They will catch you eventually. The taxman knows that you are human, if you go and talk to them they will understand and you can work it out with them. But you do not find this out until it is too late.”

3 TOWARDS A FORMALISATION SERVICE

In this chapter we define what is meant by ‘formalisation’ and a ‘formalisation service’ and seek to give an overview of the need for such services in the UK. We explore the development of formalisation services and current practices, and in doing so examine the benefits and likely expectations of formalising informal entrepreneurs.

So far, we have discussed the informal economy in general terms; however, the research undertaken focused more narrowly on a specific subsection of those engaged in informal economic activities: those entrepreneurial individuals who are informally self-employed or have established small informal businesses.

“Being registered is good. When you need financial backing from the high-street banks you can demonstrate your level of business. One of the advantages is to have access to credit from the high-street banks.”

(Cl. 4)

A formalisation service can be described as a bespoke local advisory and support service for businesses seeking to ‘legalise’ and therefore ‘legitimise’ their operations.

– Williams *et al.* (2008)

While paid employment in formal waged or salaried jobs is rightly promoted by policy-makers as one of the primary ways for people to escape poverty (Knijn *et al.*, 2007; Millar *et al.*, 1997), self-employment and entrepreneurial advancement are also important ways of increasing formal employment, and thus reducing poverty.

However, as we have shown above, punitive policy measures have done little to support informal businesses in making that transition into the formal economy. 'If a deterrence approach continues, then western governments will with each step that they take to deter informal employment destroy with one hand precisely the self-employment and entrepreneurial behaviour that they are so desperately seeking to nurture with another hand.' (Williams and Windebank, 2006). Different policy approaches, which enable compliance, are needed, and one such method is to formalise or legitimise informal entrepreneurs.

'**Formalisation**' is simply the process by which informal work becomes compliant with employment, tax and benefit laws, recognising the journey that businesses take as they establish themselves and the obstacles they need to remove along the way.

The process of formalisation takes place over a period of time and may include, among other steps: registering the business for tax purposes, submitting fully disclosed financial accounts and tax returns to the tax authority, disclosing any paid work undertaken while in receipt of benefits, providing staff with contracts and paying them the national minimum wage or above, obtaining public liability insurance, and complying with workplace health and safety regulations.

In this chapter we have included several case studies of formalisation services from Italy, Australia, the UK and Spain, which serve to illustrate the different approaches taken in terms of process and outcomes achieved.

The outcome of formalisation is that economic activities associated with a worker or business become legitimate and fully compliant with the law.

Case study: a formalisation service in Italy

In Italy, the Centre for Economic Regeneration (Centri Operativi per la Riqualficazione Economica, CUORE) was established in 1999, by the municipality of Naples and the University of Naples Federico II, in order to research the local business environment. This research revealed that the principal local labour market problem in Naples was not unemployment but the 'hidden economy'. Today, CUORE consists of a network of service centres for 'hidden' entrepreneurs in low-income neighbourhoods, providing information and advice to support their formalisation (Bàculo, 2001, 2002, 2005).

Following a request for help by an undeclared worker, CUORE advisors, familiar with local conditions, create customised regularisation and development paths for them. Advisors closely monitor each step in the process to ensure that the enterprise follows the regularisation process and that the plan continues to suit the needs of the enterprise. By 2005 1,280 hidden enterprises had received advisory services and 326 problems had been solved (Bàculo, 2005).

In addition to these CUORE centres, attempts have also been made to incentivise local businesses to do the same. As a result, business consortia have been established to provide training, arrange trade fairs, help protect the originality of members' labels and products, and offer assistance with the internationalisation of their markets. The existence of this wider supportive network creates further incentives for companies or individuals to legitimise their business, allowing them to compete on grounds other than labour costs and reducing the necessity for hidden practices (*Comitato per l'emersione del lavoro no regolare*, 2003). Since its success in Naples, this initiative has started to be replicated elsewhere in Italy.

The development of formalisation services

Over the last 30 years there has been an increase in the number of local and non-governmental organisations offering employment services to support citizens in finding paid employment (e.g. the UK's New Deal for the Long-Term Unemployed, 1998–2010; and now the Work Programme) as well as setting up and growing their own businesses (e.g. regional Business Links). Often, such services were established as a response to specific economic difficulties and high unemployment. However, an additional motivation for successive governments has been an increasing desire to involve the private and third sectors in the delivery of welfare and enterprise policy. The assumptions underlying this fall into two categories: firstly, a belief in the power of the market, and of competition, to improve the quality and efficiency of services; and secondly, assumption that the 'consumers' of these services benefit from support provided by local organisations, whose staff are knowledgeable about the local area and are thus better equipped to support people in their communities.

An unintended consequence of the development of these services has been an increase in the discovery of those who are already working, but doing so informally. This has led some local authorities, private companies and charities to develop a knowledge-based understanding of the reasons why people are engaged in informal economic activities in their locality. In a few areas this has resulted in them extending their current services or, in limited instances, developing targeted services aimed at formalising people's undeclared work and trading. Even where this has not occurred, informal workers who seek help for their debt management, benefits and tax credits issues, may also find information and support leading them to formalise their activity (McGoldrick, 2009).

Case study: a formalisation service in Australia

Many countries provide written advice, guidance and training on the records that businesses need to keep for tax purposes. The Australian Taxation Office (ATO), however, has gone one step further by providing free record-keeping computer software. This acts as an assessment tool, as it is designed to help small businesses understand the business records they are required to keep and also assists in evaluating how well the business is doing.

The ATO also supplies fact sheets for specific sectors on basic record-keeping requirements. The provision of this level of advice and support could be replicated in many other countries.

Current demand and practice: existing services

Although there are rare examples of innovative projects, there is wide acknowledgement that support and advice is not generally available at present to businesses seeking to legitimise their operations (Copisarow and Barbour, 2004; ILO, 2002a; SBC, 2004; Williams, 2005b). There is, however, clear demand for such a service: surveys conducted by Community Links have found that 46 per cent (2009) and 56 per cent (2006) of informal workers would like to formalise their activity (see also Llanes and Barbour, 2007). The difficulty, as outlined in the policy chapter above, is that these activities go against the grain of the UK government's national policy

approach, which has prioritised punitive action against informal work, despite yielding only limited results (see Table 4).

There are three other important factors that indicate the need for a model of formalisation which aims to assist self-employed and entrepreneurial informal traders. First, research indicates that sectors with a high proportion of self-employment are likely to involve a significant percentage of informal work (Dellot, 2012; Joassart-Marcelli and Flaming, 2002). There is likely, therefore, to be a significant 'market' for formalisation services targeting this particular area.

Secondly, formalisation work among self-employed informal traders is likely to be especially significant for deprived areas. Self-employment in deprived areas has been shown to be less than half the average for the rest of England (Evans and Syrett, 2006). This could mean that there is a need for services encouraging and supporting self-employed work in such areas. Equally likely is that these figures underestimate self-employment in deprived areas (Social Exclusion Unit, 2004), and that it is simply that in deprived areas entrepreneurial talent exists more commonly among people who are officially unemployed, but are actually informally self-employed and receiving benefits. Tapping into this pool of hidden entrepreneurs and businesses is the primary focus of the formalisation services we model here.

Thirdly, research seems to suggest that informality may be the necessary incubation period for fledgling entrepreneurs. (See for example Global Employment Forum (2001) *Informal Economy: formalizing the hidden potential and raising standards*, Session III-C, Global Employment Forum, Geneva, 1–3 November; and Small Business Council (2004) *Small Businesses in the Informal Economy*. London: Small Business Council; both cited in Williams and Windebank (2006)). This experience has been documented not only in small micro-enterprises in the UK but also in the tech start-ups of Silicon Valley and elsewhere (Portes and Haller, 2005). The YouGov poll for the RSA (Dellot, 2012) shows that one in five respondents had traded informally at one point in the past, and the two most popular reasons given for doing so were that they first wanted to see if their business would be viable (64 per cent), and that it gave them 'breathing space' before they had the capacity to register their business (40 per cent).

So, formalisation can be viewed as a gradual journey, with each hidden entrepreneur following their own path towards legitimacy. Enterprises may start off on an informal footing but through a steady process of growth and a careful navigation of the individual, structural and cultural drivers of informality, there is a strong possibility that many will eventually have the wherewithal to make the transition to the formal economy (Llanes and Barbour, 2007). Of course, there exist many capable hidden entrepreneurs who are unwilling to make the move towards the formal economy for reasons of self-interest, but this should not distract us from the large numbers who do aspire to one day formalise their business.

This public demand, the failure of the traditional policy of deterrence, and the limited development of formalisation services to date, clearly point to a case for the wider development of such services. However, the formalisation services we have come across tend not to have been 'developed' in such an intentional way. The majority of the organisations involved in this research did not start up intending to support informal traders and workers to formalise, but developed their formalisation services in a fairly ad hoc, organic manner as informal workers and traders surfaced during the delivery of their core services in local communities. Their primary motivation is to provide services which support the needs of the local community, including addressing their informal work. In fact many organisations we have

Formalisation can be viewed as a gradual journey, with each hidden entrepreneur following their own path towards legitimacy.

encountered still do not openly advertise this support, as in most cases to do so is actually illegal.

A further difficulty in the development of formalisation services is that although the basic service is similar in many ways to others, such as business support or employment advice, formalisation services require specific skills, and a distinctive approach. It is now commonly recognised that the kind of business advice and support required by those seeking to legitimise their business differs substantially from that required by 'start-up' or growing businesses that want to undergo a business-planning process (Copisarow and Barbour, 2004; ILO, 2002a; SBC, 2004; Williams, 2005a). As the findings in the next chapter show, a formalisation service should seek to understand and address the root causes of informality, change business practices as well as personal behaviours and navigate the delicate legal transfer procedures through the provision of highly tailored change management processes.

Current economic and political restraints mean that establishing a large or stand-alone 'formalisation' service is not feasible; nor is there any good evidence on which to build such an intervention in the UK. The development of a model for a formalisation service which could act as a guide for organisations seeking to expand their service delivery into this area is the next step in developing the wider provision of such services.

Case study: a formalisation service in the UK

In the UK, a pilot 'formalisation service' began in 2005 in Hartlepool. As part of the initiative, HMRC offered individuals engaged in undeclared work a confidential and anonymous assessment of their liabilities. If the individuals concerned accepted the assessment and paid the amount outstanding, their activities would be 'legitimised' and they would be reintegrated into the formal economy with no legal action taken against them.

Nevertheless, only one individual came forward and underwent a review of their liabilities. The subsequent evaluation found that there was a lack of knowledge of the scheme locally, alongside low levels of trust between the target group and the authorities. Moreover, the basic message of the campaign was deemed unappealing, and the failure to use an independent body, such as the local Citizens Advice Bureau, to which people could make their initial approach, was considered a further weakness (Bivand *et al.*, 2006).

Box 5: What's the difference between a formalisation service and general business advice?

A formalisation service combines a number of features that make it distinct from general business advice, such that it:

- focuses specifically on helping informal businesses, either through a dedicated formalisation service, which systematically targets and then supports these businesses to formalise, or as part of a regular business support service which, to some extent, works with informal entrepreneurs;
- addresses individual, structural, cultural and locality issues with the informal entrepreneur;

- builds a relationship based on trust, empathy and non-judgement, collaboration, positivity, respect, etc., with the informal entrepreneur, as success depends on the quality of such relationships;
- has highly skilled and committed staff, with strong working knowledge of the locality;
- addresses the root causes of informality;
- understands the motivations and barriers of informal entrepreneurs;
- changes business practices, as well as personal and financial issues and behaviours;
- provides a highly tailored change management process;
- supports people to navigate the (delicate) legal transfer process, at times interceding with the statutory authorities on their behalf;
- provides continuing support once formalised (typically anywhere up to 24 months, or even 60 months);
- does not report informal entrepreneurs to the authorities nor force businesses to formalise.

If these characteristics were taken in isolation then there would be no difference; it is in their totality that the distinction becomes clear.

Which businesses benefit from a formalisation service?

The businesses which are likely to benefit from the formalisation services we model are often micro and small. For some of these businesses, without business support and advice to aid their growth, they would not be sufficiently profitable to keep their owners out of poverty, and would be unsustainable in the formal economy. More often, however, businesses which will benefit from formalisation services are likely to be past the stage at which they simply help their owners keep out of poverty by marginally contributing to household income. These businesses will have grown to a point at which their profits are very important to their owners' total income, and their owners are no longer simply using them to 'get by' (where entrepreneurs are operating with difficulty to make ends meet), but to 'get ahead' (where they are making a steady profit and have the wherewithal to expand and eventually register their operations) (Llanes and Barbour, 2007; Putnam, 2000).

Reflecting their use of informal work to 'get ahead', and the clear prospects of success that their businesses have in the formal economy, we refer to the clients of the formalisation services we analyse here as 'informal entrepreneurs'.

Case study: a formalisation service in Spain

The Nazaret neighbourhood in Valencia, eastern Spain became home to a formalisation service aimed at a sector with a high proportion of undeclared workers: domestic services. A labour exchange was created to train and provide these trained workers to households seeking domestic staff. The exchange has contributed to formalising this sector of the local labour market. At any one time, some 60 employees are participating in this scheme. Evaluations have not been conducted, but if the initiative is found to be effective, this local formalisation service could be transferred to countries and sectors where undeclared work is prevalent.

It should be noted that we think a very different model of formalisation is needed if an employee who is engaged in informal work by their employer wants to formalise. They face two options: leave the informal job and find formal employment, or attempt to work with the employer to formalise their business practices. In reality this latter option would be very difficult and it would probably lead to the employee being sacked.

What can be expected from a formalisation service?

Although we offer a definition of 'formalisation' above, we have not yet considered in detail what is to be expected from such a service. The bulk of this analysis is contained in Chapter 5; however, one simple way of considering the main challenges that a formalisation service would have to contend with is to use the idea of the '4 Cs' (see Table 5 and Figure 6) that any informal entrepreneur must develop in order to formalise their business. The 4 Cs were developed out of conversations with the Project Advisory Group and other feasibility work that Community Links has undertaken for the development of its own enterprise service, which is now in its initial stages.

Table 5: The '4 Cs'

Confidence	To believe in the possible, that their business can be developed and run successfully as a formal business.
Credibility	To demonstrate that they are capable of running their business, by having the necessary skills and expertise.
Commitment	To show not only that they have the ability but they have the drive and passion to put in the hours and make it work.
Cash	To realise their dream through delivering a business and financial plan, accessing appropriate financial support.

Figure 6: Addressing the '4 C' gap



We argue that any model formalisation service must convincingly address these four barriers to formalisation faced by those wishing to formalise their economic activities.

Client case study 4: Joe, car mechanic

Joe, 31, is originally from Iran, but arrived in the UK to study Law in the late 1990s and stayed on legally. He is divorced and has no children. He currently trades cash in hand as a car mechanic and is not registered as self-employed with HMRC.

Joe co-owned a gallery – a legitimate business which “was all above board”. The gallery turned over £35,000 a year and Joe was able to grow the business with financial help from high-street banks. The business closed when his co-owner ran away with the business funds. Joe ended up saddled with debts.

To get by Joe has been running a garage for the last 18 months. The local going rate for car repair work, according to him, is about £35 per hour but he charges only £10 per hour, as his customers do not make much money, nor do they want to pay VAT.

Joe’s experience of running the gallery informs his opinions today about running a formal business. He thinks that to be compliant means considerable bureaucracy and financial expense. He is sure, for example, that he would need an accountant to organise his books and do his tax returns; however, he can’t afford to pay one because he is not making much money.

Joe was told about a local micro-lending organisation through a friend. He requested a loan to buy tools for his business. To him the high-street banks’ interest rates were too high. At the appointment with the loan advisor he opened up and talked about his real situation. The loan advisor told Joe he needed to talk about his ‘real’ level of business to let the organisation know whether or not he would be able to repay the loan. “His attitude helped me to be open with him about my cash-in-hand trading. He was very good, his attitude has helped.”

Joe has not yet registered his business, but he is happy. “When I am making money it would be good to register. One of the advantages is to have access to credit from the high-street banks. I can’t do it at the moment. I was thinking to do it this year, but still it is not going well. Hopefully in six months or a year I will be able to do it.”

4 FINDINGS

The research found that there are two aspects to formalisation. The findings are explored in more detail in this chapter, as are the resources an organisation requires to provide a formalisation service, and the likely outputs and outcomes it can achieve.

The most important, overriding factor in enabling a business to formalise is the quality of the relationship between the informal entrepreneur, the supporting organisation and its advisors. Without these three actors working together, in all likelihood formalisation efforts will be unsuccessful. The second aspect is the specific activities and tasks involved in facilitating the formalisation process.

Deep value:¹ the attributes of the client–advisor relationship

The evidence suggests there are seven key attributes of the relationship between a client and an advisor. They are shown in Figure 7.

Trust

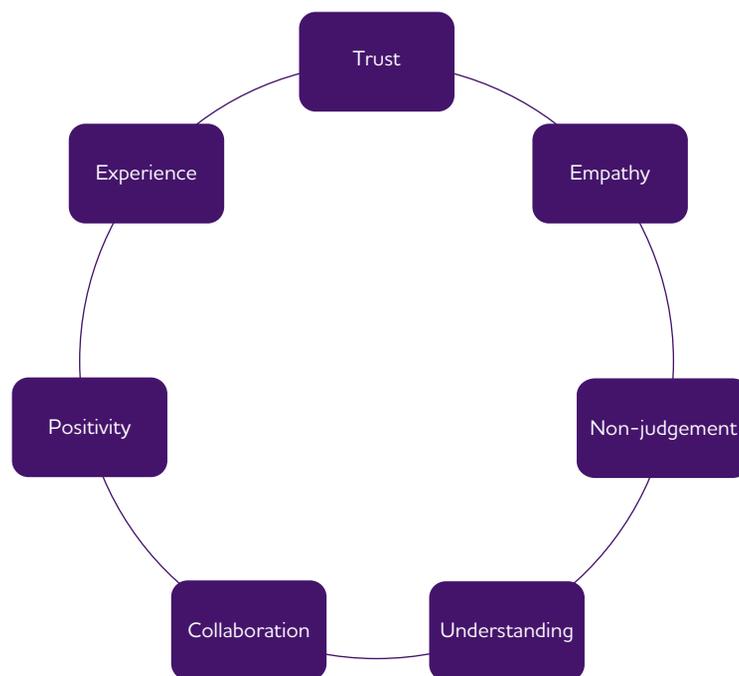
“People got to trust you, it is not rocket science. If they trust you and know what you are doing.”

(Int. 21)

“It’s a question of actually gaining trust. I think it’s showing the clients you understand the position they’re in, the sort of empathy, trust and basically [being] non-judgemental.”

(Int. 2)

Figure 7: The seven key attributes of the client–advisor relationship



The crucial importance of trust, particularly at the beginning of the relationship has been a powerful message emerging from our research. Most users are initially wary and cautious. They are scared of being reported to the relevant authorities. “It is the relationship you develop with the young people. They disclose certain things and, unless they are going to harm themselves, there is confidentiality and [the young people] trust you” (Int. 14). Some come forward because they have got tired of ‘constantly looking over their shoulders’ (Cl. 3). Advisors must overcome behaviour and expectations built on clients’ experience of previous, untrusting relationships. “They saw us as a safe venue to tell the truth of what is happening to them. Every time I have done meetings and workshops people said ‘thank god I got it out of my chest, I now know what I am going to do’” (Int. 12).

Clients talked about their mistrustful experiences with statutory services such as the local authority or Jobcentre Plus (JCP). “... when people come to us ... [they] will be very closed about declaring that they are working cash in hand because the message from JCP is so strong around fraud, and one of the challenges is to build trust” (Int. 22). And, “They start trusting me from the beginning. I just say I’m not from the council. I don’t have anything to do with the council” (Int. 1).

Once this trust is established it can give the client confidence in agreeing to be supported to formalise their activity. This trust must be maintained, and if it is, it acts as a commitment mechanism, keeping the client engaged in the tailored plan for formalisation. “The main thing for me is to gain trust from the client because quite often it is what they lack; they distrust people so much. If you can get that trust it is really a valuable thing” (Int. 8).

In building a relationship of trust, ensuring the development of a rapport between advisor and client is key. The point when rapport is established between the entrepreneur and their advisors is often the starting point of a productive relationship. According to the advisors, rapport contributes to the development of an environment in which the users can feel at ease and trusting. Where this occurs, an openness emerges which can enable the entrepreneur to share more information about themselves, such as their

business needs and the barriers they may face, and then be in a position to listen to the guidance provided by the advisors.

The approach to building trust by the advisor is often informal – not wearing suits and ties, not conducted in an office, and not using formal business or professional language. This can enable clients to let their guard down. Often the first meetings are held on neutral ground like a café, and conducted in small stages, starting simply by “having a chat over a cup of tea and a cigarette” (Int. 18).

“On just meeting people I start talking to them as human beings. ... I smoke, I roll cigarettes and that is a good tool. I would say: ‘would you like a cigarette?’ and they would accept it and go outside and then, again, that is more informal there ...”

(Int. 18)

“It [the ‘café approach’] works in helping people to formalise, because it is the place, the language, it is being surrounded by people from their own communities. I might be the expert, I might not speak the language but they know I am on their side ... They know I am not trying to create a trap ... I am trying to help them.”

(Int. 20)

“We reach people through word of mouth. I approach them and tell them that we are talking in confidence. The main point is to build rapport with them. I also gain their confidence through the little things I do for them.”

(Int. 19)

The confidence that an advisor can be trusted is sometimes brokered by local, experienced intermediaries based within a community. An important factor in convincing these intermediaries of the trustworthiness of the advisor is the longstanding reputation and recognition of the support organisation in which the advisor is based. Organisations’ locally earned trust is at the heart of building a successful formalisation service. “Eight people were involved in helping these people to formalise; that was interesting. They had, as in these cases, to win his trust” (Int. 3).

Empathy and non-judgement

Empathy and the ability of advisors to be non-judgemental were the attributes most frequently mentioned by advisors as those needed to make formalisation happen. Empathy stems in these circumstances from advisors recognising that informal work is often unplanned, an activity undertaken in order to avoid poverty – due to need, not greed. “The mainstay of the company was the business advisors. We recruited business advisors purely on the basis that they would empathise with the clients, love the clients, rock for the clients” (Int. 24).

Advisors’ ability to act in a non-judgemental manner is very similar to this. Being non-judgemental means that advisors do not pronounce judgement or patronise clients by lecturing them on the illegality of their actions, but instead adopt a forward-looking perspective, seeking to give them a fresh start.

“It all comes down to the way I behave ... And I think it’s possibly because I can get across an empathetic approach ... I make sure that everyone is always treated with respect and you are totally non-judgemental about their things, and you praise what they’re doing well – then I think you don’t tend to have a problem [with the users].”

(Int. 2)

Our research has found that where clients are treated with this respect and dignity, they felt at ease because their advisor seemed to understand why they had made those choices. “There are people who follow procedures, they do things by the rule book. [But this] is about empathising, not being judgemental and that can only come from you and not how people told you to act ...’ (Int. 14). And, “because [in this organisation] we understand that people would need to learn how to make a living, and it is very important to have a place where they can make mistakes and to learn what is the right way” (Int. 20).

But that is not to say that advisors do not challenge their clients, constructively enquiring about the details of their business and looking at how to improve it. Advisors are realistic with their clients, and can act as critical friends.

“I do warn them that the first year is going to be good, but the second year is based on the income of the previous year. I do tell them that it may be a struggle, the first year may be covered because they would get £52 a week and working tax credit and then their earnings on top of that. In the second year, this will change because now they are earning money.”

(Int. 5)

Understanding

An important element to the client–advisor relationship is that advisors fully understand their clients’ situation. By ‘understanding’ we mean something distinct from either ‘empathy’ or ‘experienced’. ‘Empathy’ in this process means the ability of the advisors to understand and not to judge the moral decisions made by their clients to work informally. ‘Experienced’ refers to the level of the advisors’ knowledge and experience in delivering high-quality services to their clients. Distinct from these two attributes, ‘understanding’ is an aspect of the relationship between advisor and client that encompasses the similarity of experiences, backgrounds or learning between the two, which deepens the connection, and strengthens the bond of trust.

The deep understanding that advisors had of their clients’ situations ranged from the day-to-day experience of dealing with ‘officialdom’ and statutory services to more specific understanding of what it is like to establish oneself as self-employed. “They came around ... giving us advice on the business. He [the advisor] had a very good understanding of what I was going through. He would talk as a friend as well” (Cl. 7).

Other advisors had previously been self-employed. This gave the advisor credibility and authority in the eyes of the client, as well as a commonality between the two on which to build.

“I am quite good with people of different cultures and backgrounds and have the ability to develop a relationship of trust with the clients. I can empathise and say I can understand what is like to be in business because I have been self-employed for a long time. It is not enough to say that you are in business, with these people you’ve got to be able to demonstrate it.”
(Int. 16)

As well as learned experiences and understanding, advisors also cited various ways in which they understood their clients in ways impossible to learn, such as having a similar cultural or linguistic background to the client (Int. 4). “... because I relocated from Africa, so I feel I can understand where they ... are coming from in terms of coming to another country, trying to engage with business support organisations, or not, and things like that” (Int. 1).

Collaboration

A relationship between advisor and client is built not only on the skills of the advisor and the willingness of the client to participate in the process but also on a process of active collaboration, where both parties are working together towards the best outcomes for everyone. “I am not trying to agree with all they say or do, and I will say ... maybe we can do it in another way. I give them options ...” (Int. 14). As with building trust, the development of a collaborative relationship between advisor and client relies to a significant extent on the quality of the rapport and amity between the two.

“Our coaching approach is on helping people, facilitating, enabling people to [go from] where they are now to where they want to be. Helping people move forward to where they really want to be rather than imposing certain journeys. It is moving from top-down imposing a certain journey or outcome to having people themselves choose [their process] and outcome.”
(Int. 9)

Advisors we interviewed often stated that involving the users throughout the process was vital. This was not only true of their efforts to help clients formalise but also more generally in helping them to develop their business from scratch or to gain access to formal paid employment. Key to enabling this collaborative relationship was transparency in the advice process, involving the client in decision-making at every possible opportunity, and being clear and open about the prospects for the client and their business at every juncture.

This transparency – clarifying what the steps were along the path to formalisation, and sharing as much information as possible along this journey – enables the client to feel in control of the process, and able to make informed decisions.

“We have got to work with the client and whenever possible we inform them of the implications of self-employment; we are trying to be as open as possible without being prescriptive. The last thing I want to do is to influence anybody. I give them as much information as possible to have them reach a conclusion.”
(Int. 8)

Advisors also cited various ways in which they understood their clients in ways impossible to learn, such as having a similar cultural or linguistic background to the client.

“You have to relate to people where they are and not where you want them to be.”

(Int. 23)

“They know I am on their side. That is fundamental: they know I am on their side, I am not trying to create a trap. I am not trying to make new problems for them, I am trying to help them.”

(Int. 19)

Collaboration means more than just a collaborative relationship between the advisor and their client. The business advisors we interviewed said that informal entrepreneurs generally face more than one challenge to legitimise. In order to address these interrelated challenges, advisors' clients often need support to engage with more than one organisation, and relationships must frequently be built with a variety of different organisations in the public, private and charity sectors. “We can't grow without a network of support around us. The majority won't be able to make the transition from a slightly more sustainable, less marginal position ... to make it worthwhile to be self-employed” (Int. 21). As a result advisors have to actively develop working relationships with other agencies and their staff, and draw on this to facilitate further productive relationships for their client.

“We've actually had the housing benefit people come here ... and that has been key to any success that we have ... It makes a lot of difference in being able to say with confidence what the housing benefit people will do and what to expect ...”

(Int. 2)

“... it has taken a lot of time to build the networks with other agencies. The referral route is easier, be it housing, mental health, etc. ... it is actually specialised support and we have maintained those relationships.”

(Int. 22)

“We had very good relationships with a couple of guys at HMRC, they were OK. They came along and talked to people, they were local officers. I knew them when I was working with the community centre, but not that well, just in meetings. The contacts helped, the whole thing was about networks.”

(Int. 23)

Positivity

Integral to the formalisation process is that it is 'forward-looking' and positive. There are two aspects important to ensuring that the relationship between advisor and client is a positive one.

First, the advisor must make a concerted effort to uphold, and where necessary, bolster the confidence of the client. Advisors often observed that a long period of unemployment or operating in the hidden economy can reduce a client's confidence. Successful employment or trading requires confidence; thus, advisors pointed out that prior to the mechanical process

of formalisation, they must first act to boost their clients' self-belief, self-esteem and confidence that they can do it.

“The idea is to build up the enthusiasm and the confidence as much as possible, but by the same token make them understand how incredibly difficult it can be to own your business.”

(Int. 8)

“It is about seeing the potential in everybody and help them believe in it and action it.”

(Int. 13)

“Those routes are not necessarily what it says on the tin ... we talk about transferable skills, that is not something they understand at the beginning, it is something we start talking about when they are in a scheme, when they are gaining confidence.”

(Int. 16)

Secondly, we found that good advisors seek to encourage the client in their journey to formalisation. Attitudes often differed between advisors on the degree to which the advisor should 'steer', 'advise' or 'nudge' the client in the right direction; however, all agreed that it was often necessary for them to play the role of 'cheerleader', encouraging people to continue with the support programme. While confidence-building is often necessary to ensure the client's success in formalising, encouragement is often required simply to keep clients engaging with the process altogether.

“A bit of persistence ... being encouraging as well [will contribute to the formalisation process].”

(Int. 1)

“Some people think that they do not have any option in life. They don't feel they've got a choice. I try to plant a seed.”

(Int. 18)

“Just because they don't seem as confident, it does not mean that they can't do it ... we always help them, work with them.”

(Int. 8)

“One of the purposes is to help them see themselves as business people ... My job with them is to ignite in people the idea of turning their trading into a business. It is a change of mentality.”

(Int. 19)

Experience

Advisors who successfully engage with clients, and help them to formalise, tend to have extensive experience of frontline delivery work, advising and supporting clients. We found that among advisors the average amount of experience in formalisation or similar work was about ten years. This depth of experience in developing relationships with clients, and long-standing

work in this field, lend great advantages to advisors seeking to help informal entrepreneurs. This aspect of developing a productive relationship applies equally to the depth and length of experience that the organisation providing the service possesses.

“There are those [advisors] who come from banking or the legal profession or big business and they can be good or not very good, either because they don’t understand innovation, risk, really what it is like to be pulling out some business. They understand how to put up a structure and systems but not what the client needs and wants.”

(Int. 2)

One of the main attributes of successful relationships between advisors and the entrepreneurs they help to formalise is that the advisors are highly skilled. While deep value relationships cannot solely be the product of advisors’ hard work and competency, there is no doubt that recruiting for, and developing, these skills in advisors is vital for a successful formalisation service.

Client case study 5: John, freelance photographer

John, 42, is single, has no children and was born in the UK. He is currently unemployed and receiving Jobseeker’s Allowance (JSA), but does freelance photography work ‘off the books’ when he can get it.

After leaving the army, John worked for a number of years as an engineer. An accident affecting his back meant that he was unable to continue in this career and he re-trained in IT. However, after working in IT for a while he gave it up:

“I worked there for a while but I was not very happy working there, because the majority of people trained in the college to get into work, [in my opinion], were taking the mickey out of the system. In the end, I couldn’t carry on and left.”

After three months receiving JSA, John got a job as a photographer in an independent high-street store, but was made redundant in 2009 and re-entered the benefit system.

He joined a government self-employment scheme, part of New Deal 25+, after being unsuccessful in applying for jobs. “I decided I really needed some help because every time I applied for jobs, I lost count how many jobs I applied to. I was getting no replies or anything.” His case was handled by Organisation 1, who assigned an advisor to help him to move into self-employment.

John had no idea how to go into business. He was sent on a two-day training workshop where he learned how to register as a sole trader or a limited company, how to pay taxes, market his business and provide good customer service. By the end of this workshop he felt prepared and confident enough to become self-employed; however, he did not have the money to support himself or buy the equipment required

to set up his photography business. His advisor at Organisation 1 suggested that he take a loan from a financial institution, but John was against this idea because he didn't think he could pay it back: "I did not know whether or not the photography business would work, I had not done my market research."

Unfortunately, the self-employed option on New Deal 25+ was very formulaic and process-driven. John had reached the phase in which he was supposed to be doing his test trading, but in reality he still had no photography equipment, so could not test the market and his business.

John lived in an area in which the local authority was providing grants to start-ups. He then went to Organisation 2 and found out that the advisor from Organisation 1 had registered him with HMRC as self-employed. Therefore he found that he could not qualify because he was not technically a start-up. The advisor in Organisation 2 talked to HMRC officials and John was de-registered. He applied for the grant again, but by this point he was no longer eligible as his time on the New Deal scheme had expired. He had to sign on again to receive JSA. John felt thoroughly demoralised:

"I kind of went depressed for a little while. The government is saying that they will give all the help we need but offices here, they don't do it right and it is kind of making the government look bad."

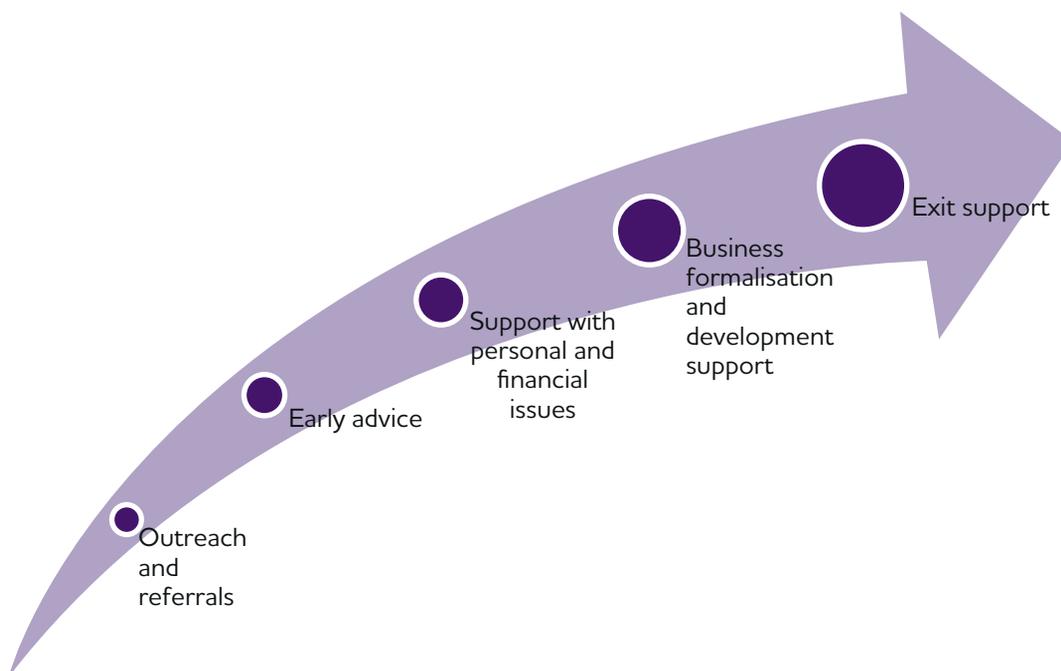
Eventually John got the grant and has bought his camera and equipment, while still having to seek paid employment. He was not eligible for the self-employed scheme for another 18 months. He continues to be supported by the advisor at Organisation 2, where he attends workshops, participates in networking activities, and is planning his business on a one-to-one basis with his advisor. John feels trapped, though: "... the thing I need is financial backing, I don't want to sign off because I have the rent and bills to pay and no money".

Activities involved in formalisation

In this section we shall describe what we found as organisations considered the practical steps and activities they took in order to develop and provide formalisation services. This process includes the development of the relationship between advisor and client; and the creation of a development plan, tailored to the needs of the individual entrepreneur, which lays out their path to formalisation.

The research suggests that organisations and their advisors undertake the activities shown in Figure 8 to enable formalisation to occur.

Figure 8: Activities enabling formalisation



Outreach and referrals

This initial stage of the delivery work consisted of advisors going out into the community, building trust and earning a reputation through outreach work and referrals. More than half the organisations interviewed started to develop relationships with their clients in this manner. As we have explored earlier, this is an important step in enabling the development of deep value relationships, and is particularly important for work among vulnerable or hard-to-reach clients.

The outreach service takes one or both of two possible forms. The first consists of informal relationship cultivation, usually face to face, with advisors seeking to engage client groups for ‘just a chat’, at times and places convenient for local people. As we’ve stated above, it starts simply by “having a chat over a cup of tea and a cigarette” (Int. 18). The second is conducted through setting up and running workshops and drop-in sessions for groups or individuals, mainly in community settings – community centres, places of worship, clubs or cafés.

“We did the standard things, we held meetings and asking if people were interested. The first thing we said was forget about the informal economy, we don’t mention that. We talk about people who want to start their own businesses, otherwise you won’t know where to start. We said we are here to help you and if you had been doing it on the side, that is not our problem.”

(Int. 23)

Both of these outreach methods build trust and enhance the organisation and advisors’ reputations. These activities also encourage word of mouth to spread messages of support and guidance, promoting the advantages of formalisation, and most importantly reassuring peers that there is no threat of prosecution if they come forward to the service. This approach has typically paid off for the interviewed organisations, as they have been successful in reaching segments of the population that have been

traditionally excluded: "... when somebody has come here, once you've developed a level of trust they will often tell other people ... Probably that's more so with some communities than others" (Int. 2). Word of mouth is a powerful tool, not only to reach further into the community but also to communicate the quality of the service, by sharing examples of success: "... by getting one party in that community to formalise, a lot of businesses may follow suit" (Int. 3).

We found that it was beneficial, as in many of the organisations we interviewed, if outreach workers were themselves local residents. People with strong knowledge of their area, who know the characteristics of the communities who live there, will find it easier to connect with local people, and clients will find them easier to relate to and trust. "The first thing we did was to ring all our contacts and told them 'this is what we are doing'. Part of [our ability to reach people] is based on the reputation we had in the area ... we had all this network of people who we worked with" (Int. 23). And, "Our project was really new: the idea was to employ someone to go out and visit other homeless services and engage with the homeless service users and day centres. The visits were to advertise our services" (Int. 18).

Advisors have told us that when running business support outreach activities they have to make absolutely clear that they do not work for the local authority or for any other government agency (Int. 1). Mistrust of government institutions and of authority is often high among people residing in areas with high indices of social and economic exclusion (Community Links & Refugee Council, 2011), and we can assume that this is an even greater problem among those who work informally. "Many have little trust that they would be treated fairly by the authorities as they would not be trusted. It is not easy, you would have to show consistency and these small business are anything but consistent" (Int. 11). Quite rationally, people simply don't want to get caught; suspicion is a great risk to formalisation services. "These, added to their fear of authorities and their way of life in the 'underground' economy, affect their outlook over openness and transparency" (Int. 11).

Being able to demonstrate a credible distance from statutory agencies was thus a crucial part of an advisor's ability to build a trusting relationship with a potential client, and it is an essential precursor to any future work together.

"Initially there was really nothing really clever about it. It was simply putting people together, meeting people and going out in their patches and talking to them about the idea of working for themselves and combating the argument that said that people who are in business do not live in our area but down the road in the nice part of town."

(Int. 24)

Outreach is important, but not necessarily an integral part of a formalisation service. Sometimes there were practical reasons for not carrying out outreach work. One of the organisations we studied simply could not do so because it did not have that kind of funding. Another reason may well be that the organisation is not best placed to carry out this work. Another organisation we interviewed had effectively outsourced this work by agreeing a referral process with another organisation (Int. 4). The implication of this process was that outreach was unnecessary – by the time the user reached the service provider their first impressions of the project had already been influenced by their contact with the outreach organisation.

“There are other people working in this package, some of these people go out and find the client for us. And then they [the users] would go through two or three channels first and then get to us. The contact with them is not very direct at the beginning.”

(Int. 6)

Once an organisation and its services were established in the community then some organisations found that people were coming of their own accord, self-referring. “The majority of our start-ups are people who come here themselves and have made the effort to make an appointment” (Int. 6). And, “Others, because we are just in the main street in this area, walk by and just come in” (Int. 7).

Box 6: Recognising informal work

For many advisors, recognising an informal entrepreneur comes down to the knowledge and experience they have built up over many years of working with such people. Identifying an informal business has become intuitive. They get a feeling that something is not as it should be following the questions they ask about the business. For others there are the tell-tale signs of work where they should not necessarily be.

“With some of our clients it is really obvious they have been working when they come in their work clothes. They will be full of paint.”

(Int. 4)

“You get a feel for it (informality) from the first inquiry on the telephone. If they say that they are window cleaners or taxi drivers, or you got somebody who is established, you get the information on the telephone. It comes down to the questions you ask. We ask basic questions, such as what they do, the company name, where they live, how long they have been trading. From this last question you can get a feel. Sometimes they will tell you they have been to the bank and the bank can't do it for whatever reason. You can just get the feeling for who is trading informally” (Int. 15)

“The odd ones will say they are declaring x amount of money, but in reality they made a higher amount. If that comes through, you talk to them about it to find out what it is all about and it is up to the individual whether or not they are prepared to tell you. There are some who have told me and some who do not tell. It is a mixture of men and women. It depends on the individual.”

(Int. 15)

Early advice

Once trust is established and a basic level of awareness has been generated about the services available then advisors coming into contact with informal entrepreneurs can move into giving early, low-level advice.

The informal entrepreneur and their assigned advisor will use their first meeting to get to know each other. Often, as trust is still low, this occurs in

an informal setting, where the client is more likely to feel at ease and open up truthfully to the advisor. “You have to be where it is good for the clients, not for you” (Int. 23). This initial meeting, as well as establishing the face-to-face relationship, acted as an opportunity for the advisor to begin to identify the particular needs of the client.

An initial assessment would often be conducted and this would enable the advisor to:

- Identify whether the business is in early stages of trading or has been established for some time (see Box 6 above).
- Begin to establish a trusting relationship and develop a rapport with the entrepreneur (see under Trust, above).
- Gain an understanding of the client’s needs, abilities, experience and aspirations as well as the potential barriers to success, and the support they might require. “We know that people need a certain amount of support ... it would be about looking about what their issues are and finding support to address them ...” (Int. 22).
- Discuss the entrepreneur’s business idea, begin to identify ways of expanding the business, or else recommending alternative routes into formal employment. “When I talk to some businesses, especially the first time, I do not jump with my forms in their face to start the advice and support. I do listen to them first properly and with interest. They go straight to their problems. In some instances, I have a tacit knowledge that they are doing their trade in an informal way from the way they present matters to me. And in many instances I clearly need to know of their formality in order to provide them with support. But, I still work with them even if they have some informality, making it my priority to get them to formalise” (Int. 15).
- Assess the ‘fit’ between the entrepreneur’s business idea and their personal situation, in order to make it a realistic and sustainable decision. “Part of the interviewee’s job with them is to ignite in them the idea of turning their ‘activity’ into a business. It is a change of mentality. They see it as an income but not from a real business. This is really typical when you are on benefits. You are only worried about getting more income to be able to make a living” (Int. 15).
- Identify some of the potential benefits of formalisation for the client (Int. 1, 2, 11, 12, 15 – see below). This can be done by building the client’s confidence and awareness of the advantages of formal work, outlining what the changes for the individual and their family are likely to be and what effect this can have on their lives.
- Start to encourage a mind-set which will underpin the client’s determination to succeed. “One of the purposes of the interviewee’s work with some trading as self-employed is to help them see themselves as business people, as entrepreneurs. Many people usually consider a business to be a business if you are operating out of a shop. They don’t see all kinds of self-employment as a business. They lack the concept” (Int. 15).

In subsequent meetings, the advisor and the user then agree upon a personalised plan of action, which includes key milestones and a timetable.

Box 7: Types of informality

Clients who formalised their business (or were in the process of doing so) with the help of one of the formalisation services we studied had the following types of informal business:

- Fully registered with all relevant government institutions, but acknowledges only a part or all of the income generated by trading (Int. 1).
- Fully registered and are paying the right level of revenue and profits taxes but their employees are either partly or wholly employed cash in hand. These businesses are not collecting income tax from their employees and not paying their employers' national insurance contributions (Int. 19).
- Partially formalised, but don't have all necessary trading licences and insurance, especially those that are required for producing and selling food. Those operating this type of business may have acquired their licences to operate a catering business but are not registered with HMRC and/or are not compliant with health and safety or environmental health regulations (Int. 20).
- Operating without complying with any of the norms and regulations required to operate and not registered with HMRC as self-employed (Int. 4).
- Registered limited companies, but not VAT registered when they should be (Int. 2).

The sectors these informal businesses operated in were varied: catering and hospitality, hair and beauty, motor mechanics, gardening, window cleaning, retail and construction. "Hair and beauty, cleaning, sandwich shops for women; I had an actress, florists. Men are usually the trades, anything manual" (Int. 4). And, "There are some industries and types of trader who are likely to be informal, such as your taxi drivers, fast-food places, delis, window cleaners, hairdressing. We have a chiropractor on our books" (Int. 15). Also, "It is especially the trades operating in cash such as the window cleaner, painter and decorator, landscaper. That individual comes to you to provide a service and is mostly paid cash in hand. There is scope for that sort of thing." (Int. 15)

There were a mix of genders: "We were reaching more women than men. Mainly shops, stalls, cooking, baking, things like that. Doing it at home and some selling at markets" (Int. 23), and a mix of company types (sole traders, companies limited by guarantee, completely unregistered, etc.): "The ones that I'm coming across on the whole will be sole traders really ... nearly all of the ones we come across would sort of fall into that bracket. There's a couple of bigger ones more within the sort of food-type business. Sometimes even limited companies" (Int. 2).

"Cash-in-hand work is usually general maintenance, painting and decorating, families in shops, very common. They are more low-key, not very established, sole traders, market stalls, even media operations. The workforce is not more than two or three people and these businesses have a mixture of non-registration, health-and-safety issues, etc." (Int. 20).

Some were even from the charity sector.

“Even from the third sector from NGOs, yeah, you get a few where people either consider themselves to be self-employed or they don’t have a formal structure around their NGOs – they haven’t registered. A lot of that is down to ignorance and people just doing things without having a formal structure, ... people looking to set up ... voluntary organisations, social enterprises” (Int. 2).

Formalisation is not for everyone

“There are people who want to move on but there is always that proportion [of people] who are happy to stay in that area” (Int. 15)

Having made an initial enquiry, or after speaking with an advisor, some people do decide not to formalise. A variety of reasons were given by the advisors.

“Yes we encounter people who do not want to formalise and there’s nothing we can do. There’s nothing we can do. I mean aside from the message we provide ... So some people will do that, some won’t. It depends on the person’s psychology or what a person wants out of life.”

(Int. 1)

They simply did not want to change their situation, maybe because there was a perception that the business had reached its limits of profitability, or because the trader had made a decision to remain at a particular level of trading as it generated sufficient income to fund the level of livelihood they wanted.

“You do get some resistance to formalisation, but it’s the way you would normally. [We] will suggest a course of action and then you just won’t necessarily hear from the client again. So they will just sort of disappear or something will happen and they will often then come back in and you can pick up again.”

(Int. 3)

Some were content with the current business set-up as it allowed them flexibility to generate an income while fitting around their lifestyle and commitments. “Quite a lot of the women have children and want to fit it in around the children. They would do a little bit in the middle of the day” (Int. 4); and “Many women who do business at home, because they face language barriers and in some cultures [because of] cultural domination, understand their income from what they are producing from home as [a simple] income and not [generated from] business” (Int. 11).

For a few their business was a hobby, which they wanted to keep as such.

“There are a lot of people who may have started as a hobby but now they are keen to do something more on it. The only people I know [who do not want to formalise] may be the eBay traders,

for one reason or another; they do not have to run around because they've got responsibilities at home.”

(Int. 11)

Some were content with the small, additional income their business generated. It met their immediate needs and they did not want to change or jeopardise this by going through the formalisation process.

“Some other people who have managed to put together a small amount of money, either from savings or loans from relatives, are not interested in registering. They don't want to register because they want to have the income from business and not risk losing the benefits (the safety net, if something goes wrong with the business). Equally, some people are not really clear of what they would need to do to make their self-employment become a real business that would generate regular and sufficient income.”

(Int. 11)

Others simply did not have the vision or necessary skills to be able to develop a viable business. They were not entrepreneurs, and had a naive understanding of what it takes to run a business.

“One of the advisors had a client who wanted to set up a café somewhere, no experience of cafés, no money to do that. We helped to develop the idea of building sheds, he got the permission to do that and he is ready to start doing it, we can support that. We have to be the critical friend. They start with one-to-one support on the various pieces they would need for the business to start, and ... [progress] to have a proper business idea with the grant start-up. Some of the clients have an unrealistic view of what it would entail to build a business, especially if they have not got the funding.”

(Int. 7)

The organisations involved then usually supported their clients to find formal paid employment as an employee – a pathway to the formal labour market. One of the difficulties faced by these individuals is being able to demonstrate their skills and experience to future employers from the informal working, and that depends on the level of trust an individual feels with their prospective employer, balanced against the likely negative repercussions of doing so. Though some did choose to disguise their informal activities as work experience or voluntary work, most chose not to share this information, which in turn reduced their likelihood of formal employment because they were not able to fully disclose their skills and experience.

Support with personal and financial issues

The interviews made clear that it was imperative for an advisor to understand and address an individual's wider support needs. Advisors must be ready and willing to act as a one-stop-shop for advocacy, counselling and referrals in order to address a whole range of problems faced by their clients. This

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stage of the formalisation process encompassed the advisors' ability to address their clients' barriers: deficiencies in certain key skills, such as literacy and numeracy, in 'soft skills' such as self-esteem and self-confidence, and also, for example, problems with poor health, insecure accommodation, outstanding debts, or unsuitable childcare. Overcoming these obstacles helped bring stability to the entrepreneur's life and therefore to their business.

“About a third [of the users] have severe problems ... generally speaking the people we help are young people who are very often in very chaotic situations and for whom to turn up on time, to present themselves, is often a mission in itself ...”

(Int. 22)

Often these skill deficiencies and broader personal issues were rectified through the supportive relationship with an advisor, and through seeing the business plan come to fruition. Where particularly difficult or persistent problems were encountered, advisors needed to refer the client to specialist organisations.

“Just because they don't seem as confident it does not mean that they can't do it. They can be very inarticulate and don't speak very good English, struggle with writing and all sorts of things, because of a lack of formal education, but they are not stupid, they know what to do, even if they don't know all the specificities ...”

(Int. 5)

Some of these issues can be deeply personal, such as a family breakdown. An advisor's intervention in such a personal problem has an inevitable consequence on the quality of the relationship with the client. Not only does the disclosure of such problems require great confidence and trust in the advisor but the experience of hearing these problems, and acting to help resolve them, connects the advisor more intimately to the formalisation process. This mutually reinforcing relationship is far more likely to be a productive one than is a mistrustful relationship in which secrets are kept and only half-truths disclosed. “Very often you are a friendly face and they will empty all their stuff on you because you are a cross between a friendly face, a Samaritan and a friendly advisor” (Int. 24).

However, there is, as we found, no 'standard' relationship between an advisor and an informal entrepreneur. An essential requirement of a successful formalisation service was having a flexible approach. Adjusting development plans and matching advisor behaviour to meet clients' varying needs and personality types were vital elements to the provision of meaningful support for clients' personal and financial issues.

“... you can't take one approach, you have to be very flexible, because they are all different. These clients are not kids, they are adults. Most of them have got life experience, most have worked, and what you have to do is coax out their abilities – most won't know it, but it is there.”

(Int. 8)

Business formalisation and development support

Following on from the initial 'early advice' process, the advisor at this stage worked to assess the strength of the business, as well as the commitment and skills of the individual. The advisor attempted to ensure commitment to the formalisation process and 'sell' the benefits of formalising. It was at this stage in the formalisation process that advisors and clients established in full detail what the requirements of formalisation were, and considered the following areas and issues:

- The estimated financial implications of formalisation for the entrepreneur.
- The formal training needs of the entrepreneur in order to establish a successful, formal business.
- Legal requirements and obligations placed on the entrepreneur.
- The health-and-safety regulations to which the business would have to conform.
- Sales and marketing requirements.
- The financial accounting and other record-keeping requirements (including moving from cash to invoice payments) placed on the business.
- Banking arrangements.
- Insurance, such as public liability and employer's liability.
- Registration needs, e.g. with companies house, HMRC for tax purposes, a local authority for trading permits and licences, and possibly a driving licence.
- What (if any) organisational support, family support and peer support the entrepreneur and the newly formalised business would require.

The advisors we interviewed generally undertook this process by developing a 'personal action plan' with the client, including a personal financial needs assessment. Out of this process a business plan, suited to the needs of the entrepreneur and their business, was produced. Advice and guidance continued to be offered throughout this time.

"You are not going to get money unless you are formalised and if you have got a decent business plan you might get some financial support. We had to demystify this business plan. People would say, 'business plan, and do a document this thick'. It is to put it in people's experience, and it is basically where you want to be in a year's time, in two years' time. What do you mean? Well, how do you start, how do you get your money? Your capital? At that level, you do not have to put it in business terms – plan where you want to go. Do not exist on a day-to-day basis ... trying to expand their minds. How are you going to promote your business? That sort of thing."

(Int. 23)

At this point, based on the viability of the business plan, a mutual decision is made either to take the business forward on a legitimate basis, or to accept that there is insufficient potential for a sustainable business to emerge. If the latter is the case then the advisor usually helps the client to find an alternative form of formal paid employment or enter further training or education.

“The idea is to build up the enthusiasm and the confidence as much as possible but by the same token make them understand how incredibly difficult it can be to own your business. Because remember, myself included, these are people who are used to working as an employee or receiving benefits, they are not used to the new requirements of setting up a business. I would rather somebody realises, in the first stages, that they are not confident than [discover] further down the line that it is not really going to work.”

(Int. 6)

All individuals then undertake a period of ‘test trading’ to allow the entrepreneur to trial the business. This period may last between three and six months. Advisers are on hand to guide and support the client through this process, and help them to navigate the various challenges of running a formal business. As well as giving advice on business-related issues, advisors were required to ensure the stability of the client, and provide advice and guidance on personal benefits, taxation and finance.

Communicating the benefits of formalisation and compliance

The messages and information developed by the advisors and their organisations are key to encouraging and persuading informal businesses to formalise. These are shared every step of the way through the formalisation process. The principle messages are positive ones, focusing on the benefits of operating formally, and include:

- the prospect of making more money;
- the opportunity to expand the business (by size, turnover, geography, new markets);
- the increased access to formal credit;
- the ability to hire more staff;
- the opportunity to advertise more widely, without fear of attracting unwanted attention;
- the elimination of the stress and psychological fear of being caught.

A clear financial transition plan is developed to show how they will be materially better off if they formalise. ‘Better off’ calculations can be done early in the advice process to demonstrate to a client their improved financial situation, while clearly showing the progression route off benefits, into tax credits and the tax system. “The majority of our clients are on some kind of benefits. Before going anywhere we make sure that they get a better off calculation, done at JCP or anywhere else” (Int. 4). For example, a client might be entitled to Housing Benefit, Council Tax Benefit, Pension Credit and Tax Credits. The better off calculation “is a key part to getting people to move, because generally speaking they’re ... prepared to give up the Jobseekers’ Allowance, but it’s the Housing Benefit that is the main one. We will help them [to sort out] the Housing Benefit ...” (Int. 2). Housing benefit is particularly key because accommodation costs, namely rent, are generally the single largest cost to a household. Without having secured this most people will not start to formalise their activity.

“You tell people, ‘if you employed three people to run three [market] stalls, you would be able to increase your income, a

lot more than the £60 a week you get on benefits. And in the meantime, you can still get Working Tax Credit as long as you tell them what you earn', most people want to formalise. As I said, it is survival."

(Int. 12)

These entitlements can be used to bolster and smooth the client's income and cash flow as they formalise their business, as well as reduce the stress and psychological fear that many informal entrepreneurs experience.

"Most people do not want to be looking over their shoulders, fearful. People in the main want peace of mind."

(Int. 12)

At times advisors will focus on the negative consequences of trading informally, to illustrate the potential pitfalls. "We also use the stick if need be, on the negative side, and say, 'You face this and this. Basically you are putting yourself at risk.'" (Int. 20). It depends on where the client is at and how best they respond. So sometimes advisors discuss how operating informally prevents the client doing certain things.

"With the sole traders it's really showing them that in a lot of ways they're often disadvantaging themselves for no reason by not declaring their business. They can't advertise, they can't advertise as a caterer, they can't advertise their services in case the enforcement agencies pick up on them and things along those lines."

(Int. 2)

An advisor will nearly always point out to a client that their informal activity is illegal, breaking the rules with one or more government department. "I would basically advise people to stop doing that, actually point out that this is potentially fraud, and then showing them that [formalisation] is the way, probably get them to see a benefits advisor at that time" (Int. 2). This is often because clients are unsure of the rules and are unintentionally non-compliant. By passing on information informal entrepreneurs can then make more informed decisions about their business and the process of formalising it.

"We would never turn anybody away, unless they are doing something illegal that puts our staff in a conflict of interest. We would have a discussion with the person about why this is a conflict of interest situation. For instance, our legal advice would be to not go to court on an appeal on benefit claims if they know that the person is working informally. We are here to support people as much as we can, and give them the information they need to make a decision."

(Int. 11).

Peer support

Advisors and organisations we interviewed argued strongly that this very specialised and personalised advice process, combined with the extensive knowledge that advisors have about the local area, local markets and government systems is the only viable way to formalise and support a business. This support is precisely that which is not being offered by mainstream and statutory institutions like Jobcentre Plus or Business Link.

“It is quite difficult because – and again, this is my opinion – Jobcentre Plus advisors don’t have a particularly in-depth knowledge of self-employment ... A lot of my clients come across that while researching the market about going into self-employment. The Jobcentre is still asking the clients to search for employment and making them attend interviews, because the fact that they are doing activities to go into self-employment doesn’t count as employment research ...”

(Int. 8)

Jobcentre advisors may face difficulties in supporting start-ups on account of the client’s misunderstanding of what actually constitutes a business. A significant number of people believe that having premises is a precondition to considering themselves to be in business, even though there are certain trades that can operate without any. “People only consider [it to be] a business if you are operating out of a shop. They don’t see self-employment as a business. They don’t have the concept” (Int. 19).

Enabling peer support for the formalising business can play an important role in the success of the formalisation process. Clients were encouraged to support each other via small groups and networking events, exchanging skills, favours and experience, as well as selling their products to each other. One organisation, after working with the users for more than three months, organised bi-weekly networking sessions, in each of which one of the entrepreneurs would showcase their business and products, distribute flyers and business cards, and demonstrate their website to the rest of the group.

“[We] get all the customers together that might benefit from talking to each other and sharing experiences.”

(Int. 5)

“I found that workshops are useful for networking, because it’s a small group (ten or eleven people). The chance that they can find somebody doing the same thing they do is very slim, but it gives them the chance to talk to people within a group environment and gives them confidence.”

(Int. 8)

“You have to relate to people where they are and not where you want them to be. We tried to get them to be part of a ‘club’ informally run by our umbrella organisation ... In these clubs you would get people who are running their businesses legit and you would mix them with people who are not. It made them feel as if

they belong and they may realise: ‘Oh, I am a business person too ...’ That was a successful plot.”

(Int. 23)

Once the trader has become confident, with some knowledge of their chosen industry, the advisor supports them to attend and join industry-specific trade associations. The specialised nature of these associations offers specific support, services and opportunities to users.

“We encourage our business owners to attend one event a month or one event every two months, at which best practice is shared. Maybe just go to exhibitions for their industry and see what’s happening, and also belong to a traders’ association for their industry ... [it] will be beneficial to their business and they give advice and support on any issues and it’s very important.”

(Int. 1)

“In the last year, our organisation helped organise 40 business associations ... into communities of traders. If people are supported, when it comes to shopkeepers, and have the business support they could become suppliers and be able to compete with others and grow.”

(Int. 19)

Finance

Finance is a big issue for clients, and access to credit is essential for them in formalising their business. Many have poor credit history and limited relationships with financial institutions. One interviewee told us that “99 per cent of the people did not have a bank account” (Int. 23). They have few assets to offer as collateral on a loan, and their previously informal status means that few clients reveal a history of successful trading, or have adequate financial records – usually prerequisites for securing a business loan. This is a problem for entrepreneurs trying to extend beyond the help of family and friends in financing their business. As a result, often the only credit available to clients is provided by high-interest loan companies, ‘payday lenders’ or illegal loan sharks, and some clients present to advisors carrying the burden of such loans already.

In one of the micro-finance organisations we studied, the loan advisor accompanies the traders at different points to both ‘witness’ the level of business conducted and be able to reconstruct a business cash flow. In this organisation, the financial support offered to traders is through personal rather than business loans, with conditions which minimise the risks the business can take. Therefore, even where supportive micro-finance organisations exist, for most businesses formalisation and accessing mainstream credit means that they can develop a credit history, making credit cheaper in the future, and this in turn strengthens the long-term viability of their business.

Another issue that advisors talked about was a mismatch between the timing of the withdrawal of clients’ benefits as they become self-employed and the time it takes them to generate a regular income and begin to receive Working Tax Credits. Advisors therefore faced difficulties in supporting their clients through these periods of financial and bureaucratic uncertainty.

“The majority are on some kind of benefits ... this lady was registered and had six months test trading ... she went into self-employment and went to JCP [to sign off] ... but it took eight weeks to get her tax credits to come through and she was living on nothing. The Housing [Benefit] was the same and the landlord was chasing her ... There are a lot of cases when the JCP does not deal with these issues quickly enough for people who want to go into self-employment.”

(Int. 6)

“People who are surviving without benefits and trading informally have already proved that they can sustain themselves in the business ... Those who are still relying on benefits plus informal trading will need a lot of support to be able to sustain the business, and here is where the intense support is vital – the issue is how they scale up that business to make it sustainable, to make it liveable, how benefits can be managed. The dependency on benefits can be gradually taken away, being careful not to replace the dependency on benefits with dependency on the advisor.”

(Int. 7)

Above all, in the process of detailed business and formalisation support, flexibility in the service offered was key. Understanding the needs of the client, and tailoring the speed of change and intensity of support to their individual circumstances, was especially important in providing services to ‘hard to-reach’ client groups. Running a business requires immense amounts of flexibility, adapting to the constant changes and recognising the decisions that need to be made. The support offered has to reflect this.

“The clients can call you any time. The point is that if you are starting any business, as a one-man business, people can’t talk to me between 9 and 5 ... I have to make myself available ...”

(Int. 3)

“[With people with multiple barriers] ... you can’t take one approach, you have to be very flexible, because they are all different. These clients are not kids, they are adults. Most of them have got life experience, must have worked, and what you do is coax out their abilities ...”

(Int. 8)

“Our coaching approach is helping people, facilitating, enabling people to [go from] where they are now to where they want to be. Helping people move forward to where they really want to be rather than imposing certain journeys. It is moving from top-down imposing a certain journey or outcome to having people themselves choose [their process] and outcome.”

(Int. 9)

Exit support

Support for a formalising business was usually withdrawn slowly and gradually in order to ensure a smooth and sustainable exit from the service. Just as the overall length and intensity of the service provided was tailored to the business and personal needs of the entrepreneur, so was the provision of exit support.

Advisors made regular contact with individuals once they had gone through the advice-intensive set-up and initial compliance process, and support continued once the business was actively trading formally. The intensity of the support required varied according to the ability of the support organisation to offer it, and the needs of the individual business. In the organisations we interviewed, it could be as much as two or three times a week, or as little as monthly, followed by quarterly contact. “I would hope that after six months with the intense one-to-one support they receive from us they get pretty much to feel confident in what they are doing” (Int. 6). Most organisations contacted their clients at regular intervals for up to three years, offering continued support and tracking their progress. “We keep in touch with clients for six months, after they have registered and start trading. It is not long. Some of them will keep in touch after that and will pop up into the office and say hi, by email, etc.” (Int. 4).

We found that exit support is of vital importance because self-employment can be very isolating, and the knowledge that there is proactive support available helps build confidence and resolution to succeed (Int. 6, Int. 7, Cl. 6). “Moving to self-employment, no matter where you are coming from, is always a scary process. There are a number of issues they have to deal with or perceive they have to deal with, in terms of tax, NI, the records they have to keep, what they need to do to be successful, etc.” (Int. 7). And, “For me the negatives of being a sole trader are that you are on your own and you are working 24 hours a day” (Cl. 6).

Even with the most meticulous planning, unforeseen circumstances may occur, but an experienced advisor can help the client overcome a threat to the business (Cl. 1).

“When they hit a brick wall, like during the recession, ... maybe they come into contact with an advisor and in the course of the advice session they discover that maybe ... they would be better off [doing something differently] ... and that’s a way they can now turn their mentality around – because some business owners are pretty satisfied the way they are, but it’s only when things are tough that they start thinking outside the box.”

(Int. 1)

Others just get “lost in the bureaucracy and all the things I had to comply with” (Cl. 6). They need a degree of ‘hand holding’, even when they are officially formalised.

Advisors are well placed to signpost newly formalised businesses to other support, such as that brokered by Business Link, or use the government’s Solutions for Business products (Int. 5, Int. 7). Assistance may be required as the business goes through a period of change, be that a very busy period and/or growth. “When I wanted to expand, I originally went naively to get money off them (Business Links). I found out that they don’t give people money” (Cl. 6). Support and advice needs may arise through adverse personal circumstances, such as periods of ill health. “I have a chronic illness and I have

an episode, which may happen every twelve years, and when that happens it takes me about two years to recover” (Cl. 7).

There may be continuing needs and problems in access to finance, particularly when the economic or business environment changes. “One of the advantages [of being registered] is to have access to credit from the high-street banks” (Cl. 5).

We found that most people stay formalised once they have got themselves and their businesses into a position where they are making more money by staying formal. “You do encourage them to get formalised ... He has moved from informal work and now he knows that he does not have to worry about getting a knock at the door and anybody grassing him up” (Int. 2). They also understand more clearly the extent of the risks and penalties of regressing as they are now part of the formal system, and importantly know where to go for support.

“In terms of lapsing back, whether these guys still have the odd cash job, whether they still ... don’t go through the books I couldn’t say, but once they’ve been formalised, particularly as a self-employed person, they’re going down this route of having a tax return to fill out. When they’ve got the tax return to fill out and, you know, to start with ... some of them actually can claim a tax refund because they’re not making a lot of money.”

(Int. 2)

This ‘added value’ service was crucial to maintaining and building evidence of the long-term sustainability of the project. Even when clients formally leave the project, they were usually advised that they could continue to contact their business advisor whenever they required any advice or guidance. “This is one thing we positively avoid: putting time restrictions on how long the traders can come and talk to you ...” (Int. 2)

Length of the formalisation process

Calculating the time it takes individuals and their businesses to formalise is helpful in allocating resources. This research found that formalisation times vary greatly between different service providers, and between different clients. This is of course inevitable when the support offered is highly tailored to the needs of each client.

Our evidence is limited, as none of the organisations interviewed systematically collected data on the time it takes their clients to formalise. Clearly, the amount of time it takes varies according to the clients’ skills, experience and resources, and relates to the amount and quality of support given by an advisor. Nevertheless, when asked to give a timescale, most said that formalisation tends to take anywhere between three months and three years.

“I would say between three months and four and a half months. If they are on benefits, again, there is reasonable time to get signed off and then get the self-employed form sent to HMRC” (Int. 8).

“Some of the other cases will be coming back to us for about two years normally. Two years is not enough to help somebody with very low confidence, potentially homeless, maybe alcoholism. There is a breadth of multiple barriers ... it is sometimes hard” (Int. 22).

“You are talking at least four sessions to formalise a person. If they are skilled. There is this one person who was a painter and decorator, became very successful; if they are skilled like that it is much easier. It might be that your project came at a time when they were ready to make the jump. You got them at the right moment in time to make the transition.”

(Int. 23)

Advisors said it was difficult to identify exactly how much time is required because not only does the intensity and frequency of the support required vary between clients but the length and type of service provided is often determined by the funder. Employment services delivered under the New Deal for the Long-Term Unemployed programme followed a rigid format, which took between six and twelve months in order to get someone set up in business or into work.

There was consensus between our Project Advisory Group members that a six- to twelve-month period was reasonable and do-able to support someone to formalise their business. “Six to twelve months is a reasonable time to expect someone to shift off benefits, into tax credits and develop their business to a point where they’re generating enough income to live off” (Advisory Group member, 2011).

Advisors we interviewed said that the entrepreneurs are, in the end, the drivers of the formalisation process. The time it takes to formalise their business depends on them and their motivations for doing so.

“... some people are doing that because they want to be out of the benefit [system], eventually, but they are trying to see if it works. So, some people will do that [formalise], some won’t. It depends on the person’s psychology or what a person wants out of life.”

(Int. 1)

Six to twelve months is a reasonable time to expect someone to shift off benefits, into tax credits and develop their business to a point where they’re generating enough income to live off.

The cost of a formalisation service

The organisations interviewed cited a variety of costs incurred in order to provide their services. Most organisations did not offer a dedicated formalisation service but undertook this work as a by-product of their existing services. This has made it difficult to develop an accurate cost framework.

Organisations quoted costs per client of anything from £1,500 to £7,500, with an average cost of about £2,500, to formalise each business. “The figures 20 years ago were £1,000 per person for the whole thing. Nowadays, it is realistic to do the job properly for £2,500 per person” (Int. 24).

Formalisation support can be more expensive as it requires specialist skills, more intensive support, and in some cases needs to be given over a longer period of time than conventional business support.

“People have told us that one-to-one support is really valuable (75%–80% of an internal survey carried out by the organisation). If that is the case, we know that it is more expensive.”

(Int. 7)

“... for those harder to reach it may cost more. It is easier to do [the formalisation and advice] in (City X) where you can see up to twelve clients a day, but if I am in (Rural Area Y) I might see two clients a day if I am lucky and drive for hours. Rural areas are much more difficult ...”

(Int. 24)

“I would have thought if you were looking at a standard sort of intervention where you have a couple of meetings with an advisor, you go on a training course and you start a business, if you are looking at it, I would have thought it was probably twice as expensive as that. But then when you factor in that actually we are dealing with probably harder-to-reach groups, we’re dealing with a lot of people where English will be the second language.”

(Int. 2)

One advisor suggested that costs could be offset by the wider benefits that formalised businesses offer, and possibly by hiring and training local residents to provide the formalisation services:

“This type of advice is much more expensive than the average cost of conventional business advice but I can’t tell you how much more expensive. The way to make it cheaper would be training a team of outreach workers to be business advisors. If you train people from the community to get some of the skills, I think that the cost–benefit is better, they are part of the community.”

(Int. 23)

We would recommend that further economic analysis is conducted to determine a more in-depth picture of the costs incurred through formalisation services and the financial benefits that formalised business return.

The results of formalisation: outputs and outcomes

It is clear that the design and specialised features of the sample organisations’ formalisation approaches contributed significantly to the success of formalising the businesses involved. However, outcomes are difficult to attribute as limited formal evaluation of these services has been conducted. This is partly because formalisation tended not to be offered as a direct or routine service; however, it is also because organisations have not wanted to draw the attention of funders and regulatory authorities to this aspect of their work.

We suggest three measurable outcomes of a formalisation service:

- sustainability of ‘formalised’ businesses;
- increase in the proportion of local residents registered as self-employed;
- decrease in unemployment levels where the support organisations operate.

Sustainability of 'formalised' businesses

The sustainability of a business is one of the key measures of its success. In general, business survival rates in the UK show that on average 80 per cent of formal businesses fail within three years, half of those failing within the first year alone. However, for the organisations we interviewed the opposite was generally the case. One of the larger organisations (Org. 8) stated that more than 80 per cent of the formalised start-ups it helped were still trading after 18 months, and 79 per cent continued after three years.

This high sustainability rate can be explained by a) the quality of the relationship-based support, and b) the business experience that an informal trader already has. Many informal entrepreneurs have already developed and tested their product and services, have a customer base and know that their business can be profitable and survive. The support they need is to formalise that activity and ensure that this does not compromise sustainability.

“If they had been trading for more than a year they are bound to be more likely to survive longer with funding and support because the business has already survived effectively for twelve months. On balance, someone who had been trading informally has got a product that people are buying and if we are providing funding and support they are going to be more successful.”

(Int. 9)

“Those who trade informally tend to do a lot more work than the others to set up their businesses. They have half of the insurance in place, half of the business plan necessary to set up their businesses ... Probably, the qualifications [i.e. Gas Safe registered] are a big difference between those who trade legally and those who are trading illegally.”

(Int. 8)

Increase in the proportion of local residents registered as self-employed

The provision of employment services and business support by the organisations studied in this report has often had locally positive outputs and outcomes. It is worth keeping in mind that the organisations we interviewed operated at a local level. Some were small outfits (the organisations' average annual turnover was £500k–£1m), though for others they were local branches of regional or national organisations. Their output reflected this.

The smaller support organisations were registering on average 80 new businesses a year. However, this number appears more significant when one looks at the context of this achievement. The majority of these businesses were founded and sustained in areas with high levels of poverty and socio-economic exclusion. In spite of this, these informal entrepreneurs, with support from their advisors and local organisations, were able to set up their businesses, formalise, and (for some) expand. “There was no pressure on getting people into business because the targets set were reachable in terms of the number of people registered (90 per cent of users). We did not pressurise advisors to get people into business for the sake of it” (Int. 24).

Seven of the ten organisations in the sample did not consistently track outputs connected to formalisation, such as the number of informal workers helped successfully into formal self-employment, or record the levels of

formalisation reached by their clients. This tended to be because such measurement was not designed into their 'formalisation' services, which were generally not intentionally offered but were by-products of existing services. In addition, most organisations did not want to overtly acknowledge these services by formally monitoring it. However, anecdotally, the advisors said the majority did formalise – especially those who were not previously registered as self-employed with HMRC. “Most of them, I would say seven out of ten, who come for advice will register” (Int. 7).

Decrease in unemployment levels where the support organisations operate

It is difficult to uncover a direct relationship between the formalisation interventions and a decrease in local unemployment levels among those previously working informally, because this data is not systematically collected by the organisations we interviewed. However, from the interviews (Org. 4, 6, 8) it is suggested that 5%–15% of those accessing employment services may be working cash in hand, and can be successfully supported into formal employment (another approach to formalising informal workers).

Clearly, greater research and more formal evaluations are required to ascertain the full outcomes of formalisation services such as those we have studied in this report. Not only could these studies help to establish the case for a change in approach to dealing with the informal economy, they could also assist in refining the model for formalisation put forward in this report, and indicating key metrics and indicators of such services' success.

Client case study 6: Mark, import/export business

Mark, 33 at the time of interview, had lived in the UK for seven years. He is married to a UK citizen and they have two young children. He is not receiving unemployment or disability benefits, but his family receives child benefit and child tax credit.

Mark arrived in the UK in September 2004, with little command of English, and soon after this he began English for Speakers of Other Languages (ESOL) lessons. At the same time, he was looking for work. The first job he got was as a hotel kitchen porter. He left this job to help a friend set up and manage a café; however, two months later he left to set up his own café. After two years of running this business, he decided to do something else; he currently rents the business to his former staff.

Having got a taste for running his own business Mark started to make use of his business connections between his home country of Turkey and the UK. He became an intermediary between UK and Turkish businesses, buying goods from factories in Turkey and importing them into the UK himself. Mark realised that he was making a success of his business and he tried to get help from Business Links to formally establish his business. He called Business Links and they told him that he should speak to an advisor [at Org. 2]. The advisor from that organisation helped him register his business with Company House and HMRC. They also helped him to develop the strategies (marketing and sales) and resources (brochures, business cards) needed to run his business.

Mark says he is doing fine. “I like selling, it is a really nice job. All my life I have been selling, I was selling cool water when I was six years old, pastries in trains. I prefer to be self-employed. I prefer independence, if I do not have any choice I would be employed. From August [2010] until this time [December 2010] we are doing fine. The business looks all right. I am looking after my money, for my two babies – I have to feed them. I am happy, I am managing.”

5 A MODEL OF A FORMALISATION SERVICE

From the research findings Community Links has been able to develop a model of a formalisation service. We would like to encourage other organisations to replicate this model in their own communities so that more informal entrepreneurs are supported in the formal economy.

There are three identifiable phases in our model (Figure 9): first, the success of a formalisation service rests on the quality of the relationship between an informal entrepreneur and their advisor. A relationship needs to be built on strong foundations of trust, non-judgement, empathy and understanding in order to aid the practical process of formalising a business, which is the second phase. Business support goes beyond the normal bounds of planning, registration with the tax office and for insurance purposes, access to finance, product development, marketing and sales, premises and training – it includes addressing a range of personal and financial issues that an informal entrepreneur may have which will affect the success of their business. The final phase enables the business to become fully formal, sustainable, and if wanted, to grow. Support from the advisor continues over a period of 12–36 months once a business has formalised in order to ensure it stays on that path.

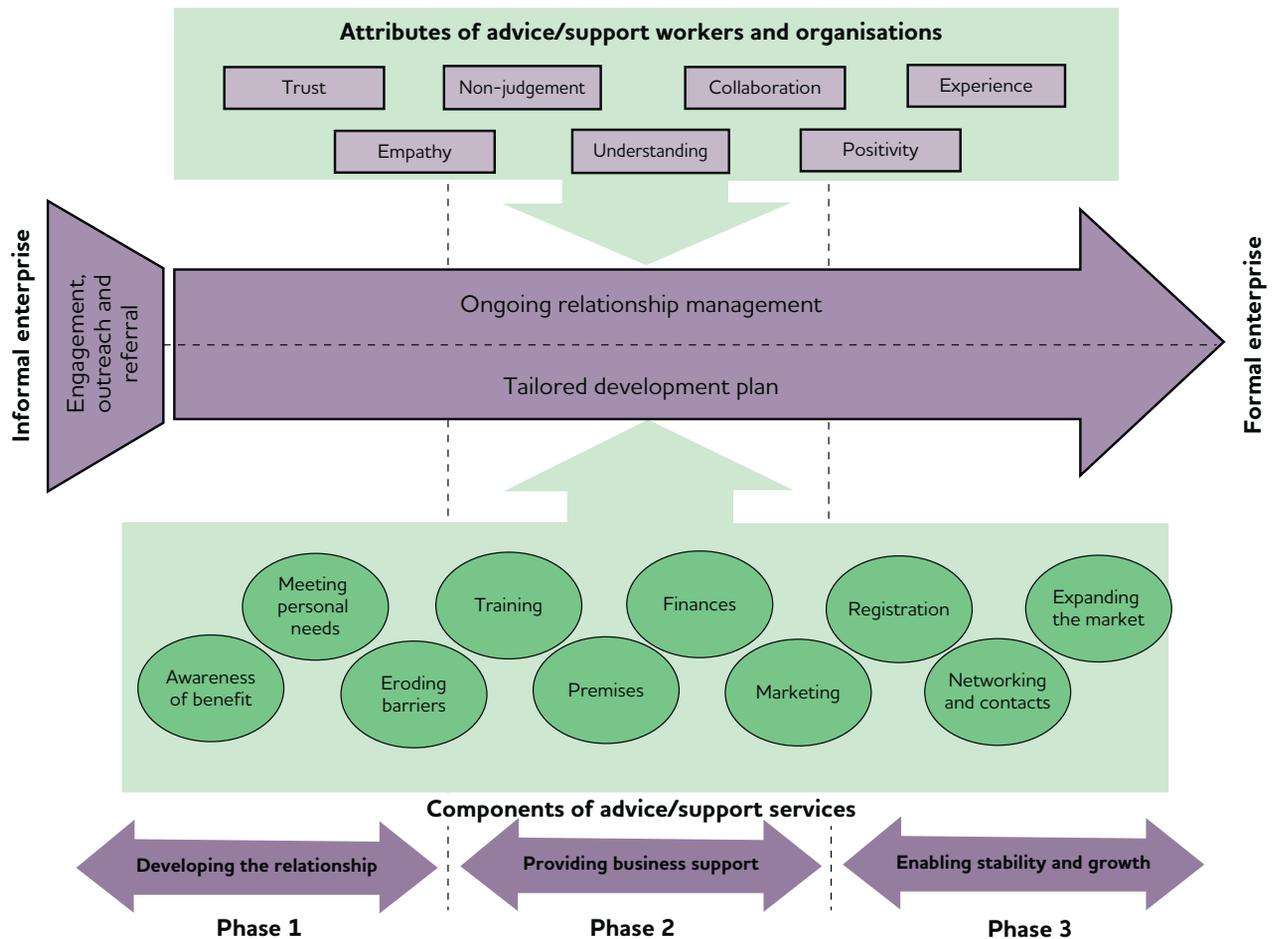
In the course of our research we found that formalisation is a process comprising a number of identifiable and replicable stages. It is therefore possible to distil several necessary features of a successful formalisation service – one which enables businesses to enter and thrive in the formal economy.

It is clear that, in order to be successful, a formalisation service should have a specific approach. However, this may not be sufficient in and of itself – there are also certain environmental and other preconditions for such a service to operate successfully. One of these preconditions that is important to note is that the formalising business must also meet

certain criteria – not every business will have the attributes necessary to successfully formalise.

The findings suggest that the most important, overriding factor in enabling a business to formalise is the quality of the relationship between the entrepreneur, the supporting organisation and the advisors.

Figure 9: A model of a formalisation service



Outline of the model

In this model there are three identifiable phases in moving an informal enterprise into a formal business (see Figure 9):

Phase 1: Developing relationships. A well-designed process of engagement, outreach and referral ensures that the supporting organisation makes an initial connection with local informal businesses. Following this, a relationship begins to be cultivated between advisors and the entrepreneur, and a development plan tailored to the needs of the business is drawn up.

Phase 2: Providing business support. Business support for informal entrepreneurs requires acting to support the client on a whole range of personal and financial issues which may affect their ability to make a success of their business.

Key components include: meeting personal needs, removing barriers (both personal barriers for the entrepreneur and business barriers), training,

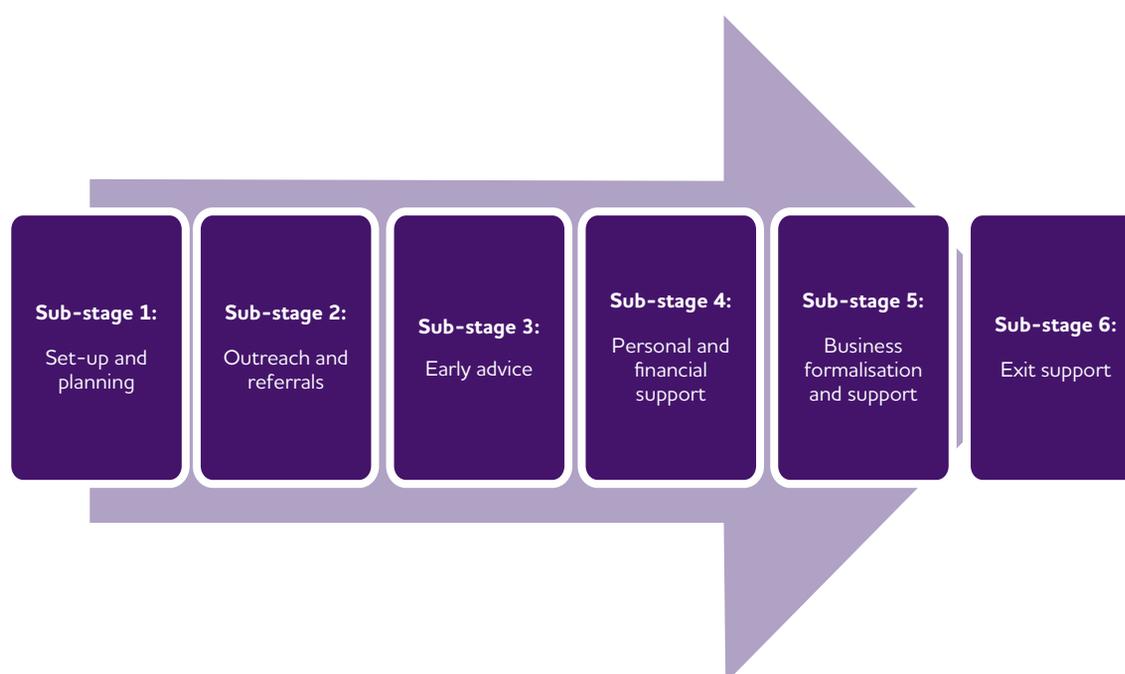
premises, finances, marketing, registration, networking and contacts, and expanding the market.

Once such support has been offered, and the relationship between client and advisor is steady and trusting, a detailed but flexible programme of support and advice is given. This works through skills development and encouraging 'hands-on' experience, gradually and incrementally building the foundations of the client's newly formalised business.

Phase 3: Enabling stability and growth. The advice and support services offered to the client are slowly tapered off, while an offer of continued support is kept open in case any further problems are encountered. The advisor works to establish the entrepreneur within a network of contacts and accessible markets in order to ensure the long-term sustainability of the formalised business.

Within the three broad phases, this model of a formalisation service comprises six distinct sub-stages (Figure 10).

Figure 10: The six sub-stages making up a formalisation service



In the following sections we consider the practical steps and considerations organisations must undergo in order to develop a formalisation service. We then go on to give a practical, step-by-step breakdown of the formalisation process. This process includes the development of the relationship between advisor and client, and the creation of a development plan, tailored to the needs of the individual entrepreneur, which lays out their path to formalisation.

Preconditions

The research identified a number of preconditions necessary for a formalisation process to be effective:

- The areas of greatest need for a formalisation service have been identified.

- The areas in which people are most likely to have been forced into informal paid work by economic circumstances have been identified, as it should be easier to formalise them than it would be for wealthier people who have actively *chosen* to work informally out of no desperate need.
- There is a willingness by those cross-sector organisations in the community to address their local informal economy and establish a formalisation service.

Sub-stage 1: set up and planning

A gestation and planning process is necessary for any project. In order for this planning process to be successful, certain information will be required, such as the period of time necessary for the service to enable formalisation and its likely cost.

The **recommended actions** to be taken are:

- Develop an evidence base of the local informal economy.
- The organisation and funder(s) work out the target population and achievable targets.
- The organisation and funder(s) define and agree on the approach to formalise informal traders (not whistle-blowing, no penalties to those trading informally, etc.).
- Risk assessments and cost–benefit analysis are conducted to ensure the viability of such a service.
- The delivery organisation(s) (e.g. business support body, advice agency, micro-finance organisation) have an established structure to deliver on-the-ground support projects, including having the right staff (business advisors, outreach workers, administrators for documenting the journey of each client).
- Outreach activities are incorporated into the formalisation initiative.
- The organisation submits proposals and secures funding from funder(s) (i.e. local authority, contractor, national agency, EU, or charitable trust).

Further research is needed to produce a more detailed cost–benefit analysis, which could include:

- expenditure of business in the (local) community (suppliers/supply chain);
- business-to-business (B2B) services bought (e.g. insurance, licences);
- tax-deductibles from business activity;
- employment generated, with a financial figure attached.

Sub-stage 2: outreach and referrals

Advisors go out into the community, building trust and earning a reputation through outreach work and referrals. More than half the organisations interviewed started their work in this way and were developing relationships with their clients in this manner. As we have explored, this is an important step in enabling the development of ‘deep value’ relationships, and is particularly important for work among vulnerable or hard-to-reach clients.

The **recommended action** at this sub-stage is to send advisors into the community to foster interest in formalising residents’ informal trading by:

- building relationships with community workers, community leaders and groups to raise awareness and encourage referrals to the service – usually face-to-face, with advisors seeking to engage client groups for ‘just a chat’, at times and places convenient for local people;

- running group workshops or individual drop-in sessions in community settings (community centres, clubs, places of worship, cafés).

Box 8: Key characteristics of organisations providing formalisation services

Many of the following features share similar roots, and may have shared underlying causes. By no means do we argue that these characteristics are all necessary conditions for a successful formalisation service; however, they act as useful indicators of quality and of potential for success.

Length of service in a community. On average, organisations we interviewed had been providing services for more than ten years. For the majority of these, the provision of employment and business support had developed out of their original work to reduce poverty.

Recognition. Perhaps due to the length of service, or perhaps because of the quality of the services provided, the organisations interviewed were generally well known by local residents.

Trust. They are trusted, with local residents believing that the organisation would act in their best interests.

Mission and values. The organisations we interviewed tended to possess a mission and set of values which reflected an understanding of poverty and social exclusion. These were organisations dedicated to serving their communities.

Local. Services were often delivered at a hyper-local level, focusing on one or two wards within a local authority area, and often operating from one building. One organisation we interviewed operated at a regional level, and two did so at a national level, from multiple locations.

Connected. Studied organisations were plugged into extensive networks, which aided them in supporting their clients to formalise.

Specific services. They tended to offer employment, business and micro-finance advice and support, as these are seen to be key routes out of poverty.

Ecology of service provision. The formalisation services we studied were part of a portfolio of support for local people. The initial approach to potential clients tended to take place through the provision of business and employment support not explicitly focused on cash-in-hand work and informal trading.

Flexibility. Organisations offered a formalisation service which was dynamic and fluid, tailored to individual client needs.

Skilled. Organisations employed advisors who are skilled and experienced at supporting the needs of the local community.

Sub-stage 3: early advice

Once trust is established and a basic level of awareness has been generated about the services available then advisors coming into contact with informal entrepreneurs can move into giving early, low-level advice.

These first meetings, as well as establishing the face-to-face relationship, act as an opportunity for the advisor to begin to identify the particular needs of the client. As these meetings progress the advisor should undertake an initial assessment to:

- identify whether the business is in the early stages of trading or has been established for some time;
- begin to establish a trusting relationship and develop a rapport with the entrepreneur;
- gain an understanding of the client's needs, abilities, experience and aspiration, as well as the potential barriers to success, and the support they may need;
- discuss the entrepreneur's business idea, begin to identify ways of expanding the business, or else recommend alternative routes into formal employment;
- assess the 'fit' between the entrepreneur's business idea with their personal situation, in order to make it a realistic and sustainable decision;
- identify some of the potential benefits of formalisation for the client, by building the client's confidence and awareness of the advantages of formal work, outlining what the changes for the individual and family are likely to be and what effect this can have on their lives;
- start to encourage a mindset which will underpin the client's determination to succeed.

In subsequent meetings, the advisor and the user will agree upon a personalised plan of action, which will include key milestones and a timetable.

The **recommended action** at this sub-stage is to offer advice on a confidential basis, with no expectation of disclosure and no commitment required. Early advice comprises small steps which will demonstrate the benefits of formalisation to the client. Meetings should aim to:

- stress the benefits of formalisation – social, emotional and financial;
- foster a desire to formalise, without pressure;
- be practical – offering flexible meeting times and locations;
- identify barriers to formalisation including fear, illiteracy, low self-confidence, lack of formal qualifications, language problems, childcare commitments, etc.;
- garner trust, providing supportive hints and tips which are of value to the informal trader immediately. These should be on practical issues such as marketing, health and safety standards, training courses, construction certification.

Sub-stage 4: support with personal and financial issues

It is imperative for an advisor to understand and address an individual's wider support needs. Advisors must be ready and willing to act as a one-stop-shop for advocacy, counselling and referrals in order to address a whole range of problems faced by their client. This stage of the formalisation process encompasses the advisors' ability to address their client's barriers, such as deficiencies in certain key skills, like literacy and numeracy, 'soft skills' such as self-esteem and self-confidence, poor health, insecure accommodation,

outstanding debts, or unsuitable childcare. Overcoming these obstacles will help bring stability to the entrepreneur's life and therefore to their business.

The **recommended actions** to be taken by an advisor are:

- provide support to straighten out the client's personal finances, e.g. by resolving issues to do with housing costs and benefits;
- work to understand and address the client's personal issues, e.g. literacy, numeracy, low self-esteem and confidence;
- understand and address wider support needs that are preventing the client from focusing on their business, e.g. childcare, poor health, benefits problems, housing, etc;
- where necessary and appropriate, refer the client to specialist support organisations to deal with these problems.

At the same time, the client should:

- Make a commitment to the formalisation process, which includes full disclosure of personal circumstances to the advisor.

There is no 'standard' relationship between an advisor and an informal entrepreneur. An essential requirement of a successful formalisation service is the ability to be flexible in the approaches taken. Adjusting development plans and matching advisor behaviour to meet clients' varying needs and personality types are vital elements in the provision of meaningful support for clients' personal and financial issues.

There is no 'standard' relationship between an advisor and an informal entrepreneur. An essential requirement of a successful formalisation service is the ability to be flexible in the approaches taken.

Box 9: Key characteristics of advisors providing a formalisation service

The advisors we encountered who assist in formalising informal entrepreneurs' businesses have certain characteristics in common. The following list, drawn out of the research findings, does not consist of the necessary attributes of good advisors but indicates some commonalities between such people.

Integral. Although this point might seem obvious, advisors who are best at helping informal entrepreneurs along the path to formalisation are those who make themselves an essential part of the process.

Competent. Advisors who form deep value relationships with their clients possess certain core competencies which are vital to a successful formalisation service. Successful advisors tend to possess a mixture of hard and soft skills with which to drive forward the formalisation process, including: the ability to build rapport and inspire trust; having excellent interpersonal skills; adaptability, and flexible in their response to a client's needs; non-judgemental and empathic of a client's situation (poverty) and their livelihood strategies (informal work).

Educated. Successful advisors tend to be graduates or postgraduates. Common fields are politics, economics and business studies.

Connected. Advisors have extensive networks and connections within the local community and the ability to work in partnership with many constituent groups in order to help people formalise their activities.

Experienced. Advisors tend to have extensive experience of front-line delivery work, advising and supporting clients. The average length of experience among advisors is ten years.

Practiced. Advisors we encountered had previous experiences similar to their clients. These included: setting up and running their own businesses; being unemployed at some point; using advisory services; and dealing with 'officialdom' in their daily lives. These were clearly important factors as they could relate to and empathise with the difficulties that their clients experienced. These situations allowed them to build rapport with the clients and also to gain their trust and confidence.

Team players. Advisors in the support organisations we studied worked well as a team. They often had regular caseload meetings to draw on staff members' collective skills and knowledge in support of their clients. Where there is only one advisor, this process tends to be replaced with meetings between the advisor and a supervisor.

Similar to clients. Some of the advisors we interviewed said that their ethnic background helped them access certain communities, for example black churches. Others stated that their ability to relate to individual users was the main asset in their advisory role.

Stable. Advisors we encountered did not move jobs often, and the organisations in our sample have low staff turnovers.

Sub-stage 5: business formalisation and development support

The advisor will in this stage work more closely to assess the detailed strengths and weaknesses of the business, as well as the commitment and skills of the individual. They will attempt to ensure commitment to the formalisation process and will 'sell' the benefits of formalising. It is at this stage in the formalisation process that advisors and clients establish in full detail what the requirements of formalisation are, and will consider:

- the estimated financial implications of formalisation for the entrepreneur;
- the formal training needs of the entrepreneur in order to establish a successful, formal business;
- the legal requirements and obligations placed on the entrepreneur;
- the health and safety regulations to which the business will have to conform;
- the sales and marketing requirements;
- the financial accounts and other record-keeping requirements placed on the business;
- the registration needs, e.g. with companies house, or local authority for trading permits or licences;
- the organisational support, family support and peer support the entrepreneur and newly formalised business will require (if any).

The **recommended action** at this sub-stage is to create a detailed plan for formalisation, to which there is mutual commitment. This process requires:

- agreement to such a plan, which includes small incremental steps, a guided timeline, defined tasks, and the establishment of targets and milestones;

- the advisor practically supporting the client to formalise by aiding their registration as self-employed and/or their attempts to obtain licences or permits;
- a comprehensive assessment of the business's strengths and weaknesses, followed by mutual agreement on a plan for business improvement, including aspects such as administration, operations, costs and pricing, exploring local customer bases and their potential for expansion, R&D, marketing, finance and funding;
- encouragement of peer support for the business by facilitating small trading groups of clients, and by organising business networking events;
- staff, supervisors and partners to hold 'case support' meetings in order to pool staff skills for optimal support and expertise.

Sub-stage 6: exit support

Support for a formalising business must be withdrawn slowly and gradually in order to ensure a smooth and sustainable exit from the service. Just as the overall length and intensity of the service provided must be tailored to the business and personal needs of the entrepreneur, so must the provision of exit support.

Client case study 7: Richard, bookseller

Richard is in his early 40s, was born in the UK, is currently single and has no children. He has formalised his bookselling business as a limited company.

Richard started collecting rare books when he was homeless. It started as a hobby, and when he got off the streets and into a flat he started selling books. He initially sold books via two websites, but was not registered. In total, he has been trading for seven years, and has been properly registered for five. In order to get support to register as self-employed he went to a local organisation which specialises in self-employment. He had previously owned a computer business and therefore already knew about registration, but he only decided to register when he realised that his business could be a going concern.

As the business progressed he started to pay for his flat and his council tax etc. – an achievement he is really proud of. After five years of trading, he decided to move the business out of his flat into new premises and was supported in this by a Business Links advisor. He had been finding it very difficult to get funding from high-street banks to expand. As sole trader he had a £2,000 overdraft, but when his business became a limited company, the bank said they could not help him any more because he had no equity or assets to guarantee a loan or overdraft. Richard's Business Links advisor put him in touch with 'Organisation 2', who supported him with a small loan and some business support.

Since receiving this help, Richard has been able to grow the business, and today he employs four local people. He says:

"Currently we are at a break-even point. We need the cash injection to expand. This is where the business begins. Before, it was basically getting the structure together, now is when we have to start making money. We're now pretty much in the formal camp. As a sole trader, if I had planned it straight, I would not have got here."

The **recommended action** is to ensure a smooth and sustainable exit from the service. This requires:

- regular contact between the advisor and client. This should be done according to an agreed, tailored plan (e.g. a six-month review process), and the type of contact (e.g. in formal or informal settings, face-to-face, telephone or email) should be flexibly arranged to suit the client's needs;
- a continuing offer of support, whether through a regular, planned process or simply by making it clear that the advisor should be contacted when queries or problems arise, for a period of time between 18 and 36 months.

The support offered should cover additional business needs as well as those of a continuing nature.

6 CONCLUSION

This two-year qualitative research study has sought to better understand how informal entrepreneurs with support from local organisations can make the transition from the hidden to the formal economy. This report analyses the context of such services, and establishes a model, based upon the findings, which can be used as the basis for the replication or expansion of formalisation services in local areas across the UK.

Ten organisations from across the UK were identified and studied, all of which were already offering formalisation support in various guises. These organisations are highly diverse, have different primary aims, offer a range of services and draw on a mosaic of different funding. Most did not set up specifically to formalise businesses. Instead, the formalisation support is often a by-product of the organisation's main work – information and guidance (IAG), business support, and micro-finance. We interviewed advisors, clients and organisational support staff in order to understand these services.

The findings show that formalisation can be and is done as a valid activity. There is a specific skill set required, and a specific approach which can be taken. There are real benefits to undertaking formalisation activity, not only at the national but at the individual and community level.

The model we have constructed from the findings details: the necessary preconditions needed for the model to work; the key characteristics required to enable the development of 'deep value' relationships of trust and commitment between the support organisations, advisors and clients; and the technical process that an informal entrepreneur needs to follow to formalise their business.

There are a number of benefits from supporting an informal entrepreneur into the formal economy. It:

- creates wealth: providing an income for an individual and their family, who in turn spend that in their local community, widening this positive economic impact;

- creates jobs: as unemployment continues to rise, and the competition for the scarce jobs intensifies, formalising businesses will create more jobs;
- increases an individual's '4 Cs' – confidence, credibility, commitment and cash – all of which build the stability of the business, and can also enhance employability;
- moves people off benefits and into the tax system;
- contributes to the local economy: the businesses provide better-quality, affordable goods and services for the markets and customers in their area. This in turn develops the wealth within a community, builds social capital and reduces the poverty and social exclusion which blight too many of our communities.

Most business ventures do not just start up overnight. People do not have idea for a business one day and begin a wholly legitimate enterprise the next. Instead, they generally have an idea, test it out to see if there is a market and then, once they know that there is a demand, decide to slowly take some steps towards making it a legitimate business concern. Businesses are vital to a healthy and sustainable economy. The prolonged economic crisis throws up the challenge for all of us to think about how we might reduce the fiscal deficit while pursuing growth. There has been a steady increase in self-employment since the recession with the self-employed now making up 14.2 per cent (4.14 million people) of the UK's workforce (Philpott, 2012). The *2011 UK Enterprise Survey Report* found that jobs are most likely to be created in small and medium-sized enterprises, and that roughly half of projected growth in the economy will come from these job-creating small businesses.

A significant minority of those businesses are trading informally. Rather than embrace these entrepreneurial businesses and bring them into the formal economy, UK policy-makers traditionally deal with them by means of deterrence and punishment. This approach, as demonstrated by HMRC's own research, is ineffective and results in government eradicating with one hand exactly the enterprise and entrepreneurship that with the other hand they are so desperate to nurture (Williams, 2006).

In recent years, though, there have been widespread calls to shift away from a repressive approach towards this hidden enterprise culture. Instead, it has been argued that there is a real and pressing need to actively help these off-the-books enterprises to make the transition to legitimacy. It is precisely this issue of how to help such businesses to formalise their operations that this report addresses.

The research reveals that there is no one, simple, quick-fix solution that is applicable to all informal enterprises. Instead, it shows the need for a multi-agency, joined-up approach. Indeed, this is nothing new. During the early years of the millennium, in the UK, there was the Informal Economy Strategy Group that brought together senior civil servants from across those government departments with a stake in tackling the hidden economy. This sought to promote joined-up policies in order to tackle this hidden enterprise culture. For some years now, however, this has ceased to operate and government departments have returned to their 'silos'. The outcome has been little joined-up thought or strategy about how to tackle this multi-faceted problem.

We therefore recommend the establishment of a hidden economy expert group, composed of government departments (e.g., HMRC, DWP, BIS, Home Office, Defra, UKBA), employer and employee representative organisations, not-for-profit/charitable partners and academics, to work towards developing a long-term national strategy to address the informal

There is a real and pressing need to actively help these off-the-books enterprises to make the transition to legitimacy.

economy. The strategy should incorporate measures that address all aspects of the hidden economy: measures that prevent or deter entry into the hidden economy, or encourage people out of it and help to retain them in the formal economy. The strategy would aim to facilitate greater co-ordination and co-operation between all stakeholders and develop expertise and capacity-building in order to improve the efficiency and effectiveness with which the informal economy can be tackled.

Practical action is more urgently required. We do not want this report to sit on the shelf, or just add to the debate. We want it to be used for the benefit of entrepreneurs who need to make that transition into the formal economy. This report provides a robust and practical model to provide such support. We strongly urge employment support providers (including those delivering the Work Programme), business support organisations, trade unions and charities to take the formalisation model outlined in this report and start putting it into action in their local communities across the UK today. In doing so, they will be extending opportunities in some of our most deprived areas, improving life chances, tackling poverty and building stronger communities.

7 RECOMMENDATIONS

The recommendations presented in this report have been developed from both the evidence presented during the study and Community Links' wider policy and its knowledge and experience of the UK's informal economy.

Priority recommendation

Establish a hidden economy expert group to develop a national strategy

This expert group could be defined as a consultative entity comprising a range of stakeholders whose mission was to facilitate greater co-ordination and co-operation of all those involved in tackling the hidden economy. The group would bring together experts from across government, employer and employee representative organisations, the third sector and academia.

The tasks of the platform shall focus on promoting and developing co-operation, developing expertise and capacity-building in order to improve the efficiency and effectiveness with which the hidden economy can be tackled.

The aims and objectives might be to:

- develop co-operation so as to arrive at a common understanding of what needs to be done to tackle the hidden economy;
- enhance and develop expertise and capacity in how to tackle the hidden economy;
- raise awareness and share information on issues related to tackling the hidden economy.

Relevant government departments: HM Revenue and Customs (HMRC), Department for Work and Pensions (DWP), Department for Business, Innovation and Skills (BIS), HM Treasury (HMT), Department for Communities and Local Government, the Cabinet Office, Home Office, UK Border Agency, Department for Education

	Local authorities
	The Scottish Parliament, the National Assembly for Wales, the Northern Ireland Assembly
Partners:	Welfare-to-work providers, business support organisations, employer representative organisations, trade unions, charities, academics

Other recommendations

Improve the evidence

HMRC, DWP and BIS should systematically collect information to assess how many new business start-ups there are once formalised, and track the longevity of these businesses. A baseline of HMRC activity should be identified to measure the impact of formalisation initiatives.

Monitoring and evaluation indicators for the Work Programme should measure self-employment outcomes, the cost of support, gross earnings and the return made from benefit savings.

Relevant government departments:	HMRC, DWP, BIS, HMT, Cabinet Office
	The Scottish Parliament, the National Assembly for Wales, the Northern Ireland Assembly
Partners:	Welfare-to-work providers, business support organisations, evaluation specialists including academics

Improve current employment support provision

Focus funding

BIS should ensure funding for local support agencies to replace Business Link as part of their enterprise growth strategy. In turn, business support organisations should work with their local council and local enterprise partnerships (LEPs) to attract mainstream funding to develop their outreach programmes.

Relevant government departments:	BIS, HMT
	Local authorities
	The Scottish Parliament, the National Assembly for Wales, the Northern Ireland Assembly
Partners:	LEPs, business support organisations

Incorporate formalisation services into employment support programmes
Work Programme providers and business support organisations should be given certain special considerations within a 'black box' approach to deliver innovative formalisation services.

- The diagnostic assessment framework should include self-employment interest and more specifically, existing informal activity.
- Jobcentre Plus (JCP) should have the flexibility and discretion to refer clients they detect to be working informally to a Work Programme provider specialising in formalisation and self-employment support.
- Providers should be assured that 'special consideration' regarding the 'duty to disclose' is part of the black box delivery model.
- Providers should be in the position to reassure clients that no recovery action is attached to the offer of support.

Relevant government departments: DWP (incl. JCP), BIS
 Local authorities
 The Scottish Parliament, the
 National Assembly for Wales, the
 Northern Ireland Assembly

Partners: Work Programme providers, LEPs

Improve pre-self-employment support

Local government agencies like JCP, HMRC and local councils should develop targeted partnerships for referring informal businesses to existing programmes like the Work Programme, or the new 'start-up hubs', work/enterprise clubs, local council's outreach programmes for tackling worklessness, housing associations' outreach programmes, etc.

There should be communication campaigns that recognise local entrepreneurial activity and the potential this has for local business growth. The campaigns should have clear and precise messages about the benefits of running a legitimate business and what type of business support is available. Outreach activities are the start of a trusting relationship, which is the cornerstone of formalisation.

Relevant government departments: DWP, BIS, HMRC
 Local authorities
 The Scottish Parliament, the
 National Assembly for Wales, the
 Northern Ireland Assembly

Partners: Welfare-to-work providers,
 business support organisations,
 accreditation awarding bodies

Staff are equipped to support clients to formalise

Introduce specialist training qualifications on self-employment and formalisation so business advisors are better trained to support people who wish to formalise their business activity. This could be included in the new POWER framework being adopted by the welfare-to-work industry, or incorporated into formal qualifications such as the enterprise coaching qualification and the enterprise champion award by SFEDI (Small Firms Enterprise Development Initiative).

To ensure consistently high-quality provision, the minimum service standards should include the principles of formalisation policy for staff to be monitored against. This would encourage providers to ensure their front-line staff had the core competencies to deliver such a service.

Relevant government departments: DWP (incl. JCP)
The Scottish Parliament, the National
Assembly for Wales, the Northern
Ireland Assembly

Partners: Work Programme providers

Test trading should be used to incentivise and increase the sustainability of the business.

Policies for test trading should be targeted to incentivise people to move into formal employment via the formalisation of their business activity. They should be tailored to the needs of the customers and designed to constitute having an impact on sustainability.

- Claimants who volunteer to attend the Work Programme and opt for the self-employment route should be rewarded with a benefits protection scheme in the form of test trading from day one, to encourage more people down this route.
- Work Programme providers should make use of the higher earnings disregards being introduced under the new system of Universal Credit to offer a prolonged period of test trading.
- Increase eligibility for test trading to prevent claimants from setting up an informal business. Giving benefit claimants day-one eligibility to test trade or go on to New Enterprise Allowance would stop people from setting up informal businesses before they relinquished their benefits. Targeting this at ESA claimants would be particularly useful.

Relevant government departments: DWP (incl. JCP)
The Scottish Parliament, the National
Assembly for Wales, the Northern
Ireland Assembly

Partners: Work Programme providers

Ensure the welfare system works for the self-employed

- Adopt a suitable payment model for benefit payments to the self-employed.
- Pre-Universal Credit: Housing benefit payments should reflect the Working Tax Credit model to allow for six-month income projections. The award of Universal Credit should be calculated on a six-month projection of a business's profit.
- Develop a suitable conditionality regime within Universal Credit for claimants moving into self-employment.
- Conditionality should be tailored to the individual and their own particular business, taking into account income projections and the hours worked. The business support should play a role in designing each individual's conditionality regime.

Relevant government departments: DWP, HMRC

If these recommendations are implemented they will contribute to supporting more people out of poverty and social exclusion and into sustainable businesses, contributing to the growth and recovery of the UK's economy.

NOTE

- 1 **Deep value** is a term developed by Community Links to describe the value created when relationships in public services are effective. In these relationships, it is the practical transfer of knowledge that creates the conditions for progress, but it is the deeper qualities of the human bond that nourish confidence, inspire self-esteem, unlock potential and erode inequality, thereby having the power to transform (Bell and Smerdon, 2011).

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APPENDIX 1: WHO'S DOING WHAT IN THE INFORMAL ECONOMY?

There is very little socio-economic data in the UK for this. One of the most comprehensive surveys is the European Union 2007 Eurobarometer survey on undeclared work in the EU, which finds the following:

Total

Across the EU the total share of citizens who say they have done undeclared work during the past 12 months amounts to 5 per cent.

Frequency

Of that 5 per cent, half performed their main undeclared activity a few times (fewer than 50 hours) in the previous 12 months and another third (32 per cent) did it relatively regularly. The vast majority (77 per cent) are only doing undeclared work 'on the side' – with not more than 5 weeks *en bloc* per year, or a maximum of 4 hours per week if the work was done regularly.

Gender

Although 6 per cent of the male population performed undeclared work in the previous 12 months, only 3 per cent of women did so.

Age

Two-thirds of the 'undeclared workforce' consists of people younger than 40 years.

Ethnicity

No ethnic group is doing more undeclared work than another. The population of informal workers reflects the demographic patterns of each member state.

Economic status

Although it is generally assumed that unemployed people are the most actively engaged in informal work, in fact they represent only a small proportion of all undeclared workers (Leonard, 2000; Pahl, 1984; Williams, 2004a). While on average only 5 per cent of the population reported that they have done undeclared work in the past 12 months, this proportion rises to 8 per cent among the self-employed and 9 per cent among the unemployed.

Community Links' own quantitative measurement research into the size of local informal economies provides further evidence of this. We found that only 13 per cent of informal workers were also claiming benefits (Community Links, 2006–2011).

In addition, detailed analysis suggests that the informal economy does not disproportionately benefit the poorest in society. Evidence suggests that deprived households tend to conduct less undeclared work than affluent households, indicating that informal work acts to consolidate rather than reduce the disparities in wealth and income produced in the formal economy (Pahl, 1984; Williams, 2004a).

Who is working for whom?

Three quarters (75 per cent) of undeclared workers work for private individuals or households. A majority of these private clients were people directly known to the worker: over half (55 per cent) of all undeclared workers did this type of work for friends, relatives, neighbours, colleagues or other personal acquaintances. A much smaller share (20 per cent), worked for other private clients, such as people that were recommended by others or who found their services by advertisements. The share of those who did undeclared work on behalf of a firm or business was approximately 20 per cent.

Employment sector

We have a reasonably clear picture of the distribution of informal work across the economy. The UK has a similar distribution pattern to the EU. Sectors most active in the informal economy are:

- Household services. Almost one in five undeclared jobs across the EU are found in this sector, which includes domestic cleaning services, childcare and elder care provision.
- Construction. Approximately one in six undeclared jobs is found in areas such as maintenance work, household improvements and construction.
- Personal services. Services such as hairdressing comprise nearly one in ten undeclared jobs in the EU (Renooy *et al.*, 2004, p.109–10; Williams, 2008).

The challenges that this picture of the informal economy presents to government are great. It is clear that the approach government must take in tackling informal work must be multifaceted and thoughtful. People's rationales for working informally are complex and varied, and this is reflected in the diversity of informal working types and practices.

In addition, in attempting to tackle informal work, the motivations of the customers of informal workers and businesses must be taken into account. These are also highly varied, and reflect these customers' specific needs, which must be addressed alongside any attempt to formalise the businesses providing them with services.

Self-employment and informal work

There are misconceptions about self-employed people operating informally. It is hardly uncommon to get two quotes from a garage or painter and decorator with the lower quote dependent on payment by cash. There is a complicit assumption between both parties that VAT will not be paid.

The few studies on the subject, however, indicate a more nuanced reality (Community Links, 2006–11; European Union, 2007; Williams, 2004a). Interception surveys conducted by Community Links in several local authorities in England show that between 12 and 13 per cent of those who have disclosed their cash-in-hand work in the previous year also defined themselves as self-employed. This proportion of self-employed people operating in the informal economy mirrors the number of self-employed people in the UK's formal economy (ONS, 2009).

One of the most dynamic areas of public policy aiming to tackle informal working is that which aims to ease the transition from unemployment to self-employment. This raises a fundamental question: why not design policy in order to support those who are informally employed to move into formal and declared self-employment?

APPENDIX 2: RESEARCH METHODOLOGY

Community Links developed the following research methodology to undertake the work.

Literature and policy review

To gain a better understanding of the informal economy and particularly formalisation services, we conducted an international literature and policy review.

We conducted key-word searches using a combination of the following words and phrases: 'formalisation service', 'business formalisation service', 'self-employed formalisation service', 'informal economy', 'hidden economy', 'undeclared work', 'grey economy', 'informal economy policy/ies'. We developed a long list of academic articles, research papers and government policies, and then shortlisted the most relevant to the UK context.

From this literature and policy review we were able to develop two topic guides (see Appendix 3): one for the organisation's advisors and staff, and the other for informal entrepreneurs.

Qualitative research

Community Links' research team put together a list of 60 organisations using the following selection criteria:

- Are they located in England and Wales?
- Do they provide employment and business information, advice and guidance?
- Is a proportion of their users likely to be informal workers or traders?
- Does the organisation offer its services to informal traders and workers, and provide some sort of formalisation process?
- Is the organisation willing to participate in the study?

The list was assembled from existing contacts of known individuals and organisations that Community Links had built over the previous nine years of research into the informal economy, as well as peer recommendations and referrals.

From making contact with all 60 organisations, it became apparent that a number were ineligible to take part in the research. These were those organisations who said they:

- did not work with informal traders or workers (who comprised the majority of those contacted). We did suspect that some weren't being entirely open with us, but we had to rely on the willingness of the organisations to disclose their formalisation activities;
- had helped informal traders or workers to formalise, but did not currently do so, and therefore did not want to participate;
- were currently providing support to informal traders or workers but were not in a position to take part in the study. The most common reason was fear of their statutory funding being jeopardised by being identified as having worked with people who were not compliant with the law – even though we offered anonymity (see ethics section below). Several refused to take part because of the time commitment, or simply did not want to publicly share what they were doing.

Ten organisations finally agreed to take part in the research. These ranged from large national companies with multiple offices to small, hyper-local charities. These profiles will not be shared to ensure their anonymity. The Community Links research team then visited and observed these ten organisations as they went about their day-to-day work. We conducted 35 in-depth, semi-structured interviews with CEOs, board members, managers, front-line staff and advisors, and clients.

Analysis and report

The transcriptions were undertaken by the research team to ensure confidentiality. All of the transcribed interviews were stored in a secure Word document.

The team's analysis focused on the following:

- Drawing out the context of the organisations' formalisation interventions.
- Understanding and sharing the mechanisms by which the clients were supported in their journeys to formalisation. These mechanisms operate at various levels and include: the broad approaches the services adopted, the ways in which advisors attempted to cultivate a relationship of trust with their clients, and the individual steps taken in the advice and support.
- Identifying the outcomes of the organisations' formalisation services. Questions considered therefore included the following: Did the users successfully formalise their businesses? What were the factors contributing to their success? Were there any structural limitations to clients' active efforts to formalise their economic activities, and if so, what were they?
- Documenting in detail some of the clients' journeys to formalisation. Their cases were analysed in detail, and have been included in this report in order to illustrate the diversity of journeys taken and the individual barriers and opportunities that different clients faced.

Overall, the team's analysis sought to respond to the primary research questions:

- What were the implementation processes and mechanisms that worked?

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- For whom were these processes and mechanisms more appropriate?
 - How were these processes and mechanisms used?

This analytical approach thus informed the 'model' of formalisation presented in this study.

Various drafts of the report were written and improved upon within the research team, by four expert readers, and by members of staff from the Joseph Rowntree Foundation.

Ethics

The illegality of informal work posed a serious set of ethical questions for Community Links' research team to address. As we abide by the SRA Code of Conduct and our own internal confidentiality and protection policies, we decided upon the following:

- Every person involved in this research gave their consent freely. A written briefing paper and then a verbal brief were given to all participants telling them about the project and the scope of their involvement. We also prepared confidentiality statements for the organisations and individuals taking part in the study.
- We agreed that all participants and organisations taking part in this research would remain anonymous.
- Every aspect of the research process was looked at by the research team to ensure confidentiality every step of the way. For example, all interviewees gave their consent to have their conversation recorded. The research team did its own transcriptions of the recordings, again to ensure confidentiality. In neither the recordings nor the transcripts is there any mention of the names of either the organisations or the interviewees; codes (Int. #) and (Cl. #) were used exclusively, as previously defined.
- Any data collected would remain confidential to the Community Links research team only, and would be destroyed after a reasonable period of time.
- All data collected would be stored in a single, secure location with restricted access.

APPENDIX 3: TOPIC GUIDES

Topic Guide 1 – Organisations

Context

- 1 Tell me about: this area; the types of community (immigrants) in the area; are they recent?
- 2 What are the main economic activities in the area?
- 3 How are the various communities involved in those activities?
- 4 Is self-employment important in BME communities in the area? How? Why?
- 5 When was this organisation established?
- 6 What were the reasons for its creation? What were the services this organisation initially offered?
- 7 Have these services remained the same? Have they changed, expanded?
- 8 What have been the sources of funding (i.e. grants from charitable organisations, contracts with statutory agencies)?
- 9 How many people work in the organisation? Volunteer and/or paid staff? Do they work part- and/or full time?

Mechanisms

- 1 How was your organisation drawn to offer business advice?
- 2 When was that?
- 3 How has the service developed during this time?
- 4 How did you, personally, get involved in providing business advice?
- 5 How long have you done it?
- 6 How long have you been working with this organisation? Did you start as a business adviser?
- 7 How many people offer business advice in general, and formalisation in particular, in this organisation? Is funding a limitation to expanding it?
- 8 Is your position full time?
- 9 How many people have you advised?
- 10 Can you tell me about the approaches you have taken to reach people and start the process of formalisation?
- 11 How has the issue of formalisation come up? How have you approached it?
- 12 Are people initially open to the message of formalisation? If not, what do you do to warm them up to the idea of formalisation?
- 13 Which business areas are your advice clients interested in taking up, or already engaged in?
- 14 What are the characteristics, broadly, of those seeking business advice and, specifically, formalisation? Are they mostly from BME communities, young or mature, men or women?

-
- 15** Based on your experience, if someone asked you how much it costs to formalise an informal trader, would you be able to suggest an amount?

Outcomes

- 1** How many people have you advised in the time you have been working in this line of work in this organisation?
- 2** How would you say that your approach to formalisation has been successful?
- 3** What is the proportion of those open to formalisation in comparison to those who do not want to formalise?
- 4** Of the people you have advised on business issues, what proportion had been working informally?
- 5** Can you tell me the steps informal traders take towards formalisation?
- 6** Do they do it gradually? If the majority does it gradually, what would these steps be?
- 7** Do the gradual nature of the formalisation and the steps taken, in your view, depend on the particular informal trader? Is there any part of this process that is common to all who are seeking to formalise?
- 8** Would you say that there is a given length of time to formalise? If so, how long will it take?
- 9** What is the proportion of those who formalised progressively?
- 10** Do you know whether those who formalised have stayed in business? For how long? If they did not, what were the barriers to staying formal?

Topic Guide 2 – Clients

History of the business

- 1** What is your line of business?
- 2** When did you start?
- 3** What made you start?
- 4** Who are your typical customers?
- 5** How do you get your customers? Do you advertise? Word of mouth?
- 6** Do you work: (a) alone; (b) with family members; (c) with friends; (d) in a business partnership?
- 7** If you do your business with other people, do you pay them? Do you share the profits?

Considerations about business registration

- 1** How did you get in touch with this organisation?
- 2** What was your experience?
- 3** How did you tell the advisor that you had been trading/working informally?
- 4** Were you afraid of telling him/her? Why?
- 5** Did s/he talk to you about the benefits of formalising? What did you think?
- 6** Had you thought about formalising before the advisor brought it up?
- 7** What did you do to get formalised?
- 8** How long did it take you to register your business?
- 9** Why did it take this long? Were you sure that you wanted to register?
- 10** What was the message that helped you make the decision to get registered?
- 11** How long have you been working 'formally'?
- 12** In your experience, was this the right decision? What have been the advantages for you?

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Confidentiality and anonymity

To protect confidentiality and ensure anonymity, all names of those who have been involved in this research have been changed.

ABOUT THE AUTHOR

Aaron Barbour led Community Links Policy Research and Campaigns work from 2004–2012. In this role he contributed to over 25 reports on the informal economy and oversaw national policy changes to the benefit system and responses to cash-in-hand work as a result of Community Links work. Aaron is an expert advisory member of the HMRC Hidden Economy Group; a founding director of Adult Enterprise and has recently taken up a role as Chief Executive of the Katherine Low Settlement a multi-purpose community and social action centre.

Marlen Llanes has over 20 years' experience in the not-for-profit sector as a qualitative and quantitative researcher and community development worker in the UK and in Central America. She is experienced in understanding the impact of social and economic policies – particularly upon the most socially excluded members of the community. Marlen completed a PhD in Urban Planning and Policy Development at Rutgers University USA and currently teaches with the Open University.

ABOUT COMMUNITY LINKS

Community Links is an innovative east London charity working with more than 16,000 people every year. Our national research and policy work is rooted in the knowledge gained through a wide range of practical projects and services delivered locally. Through a network of community projects and social enterprises, we help disadvantaged children, teenagers, adults and older people, empowering them to fulfil their potential and build a brighter future together. Visit: www.community-links.org

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