



## **The Role of Trust as an Informal Institution in the Informal Sector in Africa**

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### **Abstract**

The study analyses an unexplored issue of how trust, framed as an informal institution, plays an important role in business operations in the informal sector by filling the vacuum left by the lack of formal institutions. It brings together 'snapshots' from other studies that show how trust plays a role in the informal sector. In the author's approach, trust is framed under informal institutions. Under this framework the author presents a larger picture of the significant role of trust as an informal institution used in the business operations within the informal sector in Africa. In the study, trust is analysed from two main dimensions, namely: Social Networks Dimension and Business Cooperation Dimension. The study is divided into four main sections: the first section presents an overview of the informal sector; the second section analyses the Social Networks Dimension, the third section analyses the Business Cooperation Dimension, and the fourth part concludes by hypothesizing a causal relationship between trust, the two dimensions, and socio-economic development.

**Key Words:** trust; informal institutions; informal sector

### **Résumé**

L'étude analyse la question inexplorée de la confiance qui, lorsqu'elle est perçue comme une institution informelle, joue un rôle important dans les opérations commerciales qui rythment le secteur informel en comblant le vide créé par l'absence d'institutions formelles. L'étude compile des « images ponctuelles » présentées par d'autres études qui soulignent le rôle important de la confiance dans le secteur informel. Selon la perspective de l'auteur, les institutions informelles constituent le terreau fertile à l'existence de la confiance. Dans ce même cadre, l'auteur réchampt ensuite le rôle de la confiance en tant qu'institution informelle dont le secteur informel en Afrique se sert dans ses opérations commerciales. Cette étude analyse la confiance à l'aune de deux dimensions principales, à savoir: la dimension Réseaux Sociaux et la dimension Coopération entre Entreprises. L'étude s'articule autour de quatre principales sections: la première partie présente une vue d'ensemble du secteur informel, la deuxième

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section analyse la dimension Réseaux Sociaux, la troisième section analyse la dimension Coopération entre Entreprises, et la quatrième partie conclut en émettant l'hypothèse de l'existence d'un lien de causalité entre la confiance, les deux dimensions, et le développement socio-économique.

**Mots clés** : Confiance, institutions informelles, secteur informel.

### **Introduction**

Since 1971, when Keith Hart first coined the term 'informal sector' from his fieldwork on small enterprises in Accra, Ghana, and the subsequent internationalization of the term by the International Labour Organization in a Mission Report on Kenya in 1971 and 1972 (King 2001:97), the sector has been widely and variously studied by scholars from different disciplines, as well as organizations that participate in Africa's economic development. Most of the early studies that were conducted by both individual researchers and institutions from different countries were done under the auspices of the ILO and the Jobs and Skills Programme for Africa (JASPA). Although the informal sector is also prevalent in other developing countries, Africa has been more of a target for studies on the sector due to the fact that the activities of the informal sector have existed much longer in African countries than in other developing countries (ILO/JASPA 1982:9). The earliest work on the informal sector focused on the towns and cities of Africa. Later, the existence of the informal economy in rural areas was also recognized, although scholarship in this area tended to concentrate on the non-farm productive activities of rural dwellers rather than on subsistence or cash-crop agriculture (King 2001:97-99). To African countries this sector has been an important contributor to GDP as a source of jobs, income, social services, and also provides a training ground for human development. But one of the challenges that faced African countries in the 1990s was mastering the dynamics of the informal sector as it was emerging as a salient element of African development (United Nations 1996). Apparently, this challenge continues to face African countries as the sector increases in size.

When the informal sector was initially put in the spotlight in the 1970s, governments neglected it for its backwardness and social scientists ignored it because of oversight or lack of interest (ILO/JASPA 1982:11). A decade later, in 1982, ILO and JASPA noticed that due to the growth of the sector it had become a focus of at least periodic attention by governments and of rather more sustained attention by social scientists. In the 1990s the size of the sector had increased to the point where it was a prominent component of most African economies and could no longer be neglected as a mere stage for businesses that were yet to be formalized. Emmeriji (1991:9) points out that during the early 1990s initial expectations that the informal sector

would soon be absorbed into the formal had given way to the realization that the informal sector was here to stay, and the informality even seemed to be spreading. According to Mhone (1996), the promotion and expansion of the informal sector was reinforced by the intractability of the problems of economic stagnation and recession, inequity and declining per capita incomes in many of the countries in sub-Saharan Africa. By the mid-1990s it was evident that the informal sector was making an invaluable contribution to the economic and social development of Africa. By then, it accounted for over 20 per cent of Africa's gross domestic product (GDP), while providing 60 to 70 per cent of employment (United Nations, 1996:v. Since the late 1990s, the transformations that the sector has undergone have prompted scholars to study it with a particular interest on its role in economic development. As a result, the preoccupation with the informal sector has generated a substantial descriptive literature based on numerous surveys, on the basis of which a number of economic policies and project ideas have been recommended and attempted in Africa (Mhone 1996).

Although various social scientists have analysed the sector, most of the knowledge on developmental issues that affect the sector has been generated by economists. The drawback of using economic models to study the informal sector is that the role of informal institutions in the informal sector has been largely neglected. But social scientists who have analysed the sector have also not done well in elucidating how informal institutions play a significant role in the operations that take place in the sector. Most of the studies that try to show how business operations take place in the informal sector in Africa seem to focus on questions related to formal mechanisms. But there are a few studies that have tried to show how informal institutions play a role in the business operations although that was not the reason they were mentioned. Instead, it seems that scholars inadvertently mention them in 'snapshots' in their analyses without clearly expounding on them. Therefore, there is a need to try and take these 'snapshots' and bring them together systematically to present a larger picture of how informal institutions play a significant role in the informal sector.

This study therefore has two main goals: it attempts to briefly show how trust, framed as an informal institution, plays a significant role in the informal sector, using two dimensions, namely: (i) Social Networks Dimension, and (ii) Business Cooperation Dimension. The study attempts to accomplish the two goals by trying to bring together the scattered 'snapshot' analyses on the role of trust in the sector and frames trust under informal institutions, and then subsequently presents a larger picture of how trust as an informal institution has been important in the operations that take place in this sector.

The methodology used for this analysis follows a small-N case study approach, in the sense that I have tried use evidence from the existing literature on actual case studies that have been undertaken on the informal sectors in sub-Saharan African countries from different regions. Utilizing the existing evidence, I try to corroborate my argument that trust is prevalently used to fill the institutional void that has been left by the lack of adequate formal institutions to build social networks and enhance business cooperation. The study is divided into four main sections: the first section presents an overview of the informal sector; the second section analyses the Social Networks Dimension; the third section analyses the Business Cooperation Dimension; and the fourth part concludes by trying to hypothesize a causal relationship – subject to empirical research – between trust, the two dimensions, and socio-economic development.

### **Overview of the Informal Sector**

Defining the informal sector has always been a controversial issue among researchers and organizations that specialize on this topic. Generally, in the informal sector, small enterprises operate outside the formal economy, utilize lower levels of investment and less demanding skills, and handle relatively simpler products. In terms of the workforce, small enterprises may employ from a minimum of one or two persons to as many as ten or more employees or working family members (United Nations 1996). The majority of people in the informal sector are, therefore, involved in small businesses that are vital to economic development. The ILO's study in 1972 defined informality as a way of doing things characterized by (a) ease of entry; (b) reliance on indigenous resources; (c) family ownership; (d) small scale operations; (e) labour-intensive and adaptive technology; (e) skills acquired outside of the formal sector; (g) unregulated and (f) competitive markets. This definition was not widely accepted since other competing definitions were still emerging. For example, the United Nations (1996) broadly defined the informal sector as any business or enterprise that is not formally registered with the national or local government. At the same time, the United Nations Development Programme, an agency within the UN, defined the informal sector as home-based or individual enterprises with few or no employees, which are also known as micro-enterprises (UNDP in UN 1996:50).

After many years of controversy concerning the nature of informality, the frontier between formality and informality, and the homogeneity or heterogeneity of the informal sector, two characteristics emerged as operational criteria for identifying informal sector enterprises: small size (micro-scale); and the extent to which an enterprise avoids official regulations and taxes (Louis 1991:11). The definition of the informal sector used in this

article follows the ILO's (2007) conceptualization of the informal sector, which divides the sector into four broad categories: (a) Own-account workers in survival-type activities; (b) Paid domestic workers in households; (c) Home-based workers ('disguised wage workers') in production chains, and (d) Self-employed workers in micro-enterprises with or without contributing family workers or employees.

Ghana has one of the largest and most diverse informal sectors on the continent, which spans activities such as trading, spare parts, transportation, construction, agriculture, livestock, food preparation, credit facilities, refrigeration, electricity, dressmaking, etc. The informal sector in Ghana has for a long time been characterized by mainly self-employed entrepreneurs, who are known as the worst tax evaders in their attempts to avoid interaction with formal institutions (Ayee 2007). In a study on the appropriate mechanisms for taxing the informal sector, Ayee (2007) points out that taxing the informal sector is a daunting and herculean task because there is no culture of tax compliance due to different informal rules, values and beliefs from the formal ones. An atmosphere of trust is one of the important values that Ayee (2007) points out as lacking in the relationship between the government and the informal sector. He makes the recommendation that, in order to tax the informal sector in Ghana successfully, the state will have to increase its capacity to perform its extractive role through promoting an atmosphere of trust. Using an institutional framework, Ayee's (2007) recommendation highlights the need for interdependence between the formal institutions of taxation and the informal institution of trust in order for the state to be successful in promoting the increase of labour market activities.

The informal sector covers a wide range of labour market activities that combine two groups of different nature. On one hand, the informal sector is formed by the coping behaviour of individuals and families in economic environments where earning opportunities are scarce. On the other hand, the informal sector is a product of the rational behaviour of entrepreneurs that desire to escape state regulations (World Bank 2007). The informal sector activities can be described under two categories, namely: (a) Coping strategies – these are survival activities, such as: casual jobs, temporary jobs, unpaid jobs, subsistence agriculture, multiple job holding; and (b) Unofficial earning strategies (illegality in business). Unofficial earning strategies have two types of activities: (i) Unofficial business activities, which entail: tax evasion, avoidance of labour regulation and other government or institutional regulations, no registration of the company; (ii) Underground activities: crime, corruption – activities not registered by statistical offices. In general, these activities have been stimulated by various forces that emerge from a range of economic and political dynamics (World Bank 2007).

As a result of various economic and political dynamics, the informal sector has experienced exponential growth in a number of countries on the continent. In many of these countries, small scale producers have been driven into the sector by a heavy burden of taxes, bribes, and bureaucratic hassles (Azuma and Grossman 2002; Tripp 1997). According to Mofokeng (2005:3), the growth of the informal sector has been accelerated by structural adjustment programmes, economic reforms and instability, and lack of national economic growth. Apart from laying the foundation for promoting the evolution of large firms that ultimately dominate the formal sector the informal sector plays a significant role in economic development by providing employment opportunities in both rural and urban settings. At the beginning of the 1990s the United Nations New Agenda for the Development of Africa (UN-NADAF) speculated that in the decade of the 1990s the informal sector would be the most important labour sponge in Africa's labour markets, where it will provide some 60 to 70 per cent of job openings (United Nations 1996). By 2005 it was clear that the informal sector had achieved and was surpassing the speculated 1990 targets and was now absorbing more workers both from the formal sector and those that were unemployed. The informal sector in Africa has now absorbed more than a half of the active population in different countries. For example, by 2005, the proportion of workers absorbed by the informal economy in Burkina Faso was 80 per cent, in Ghana 90 per cent, in Kenya 72 per cent, in Mali 80 per cent, in Tunisia 50 per cent and in South Africa 53 per cent (Mofokeng 2005:5). It is therefore clear that the informal sector plays a very important role in economic development.

### **The Role of Trust as an Informal Institution**

Trust in individuals and institutions usually expresses the beliefs about the predictability of actions (Fukuyama 1995). Predictive stability is fundamental in the interaction between individuals in a society, because if a society is able to process the information originating from its environment and itself and predict the problems and their solutions, it can stay on its desired path of development (Fukuyama 1995). Humphrey and Schmitz (1996) distinguish between three different elements of trust:

- a) Contractual trust – that the businessman will act honourably;
- b) Competence trust – that the businessman has sufficient technical and organizational capacity and capital or credit-worthiness to fulfil his obligations; and
- c) Goodwill trust – defined as mutual expectations of open commitment to each other. Goodwill trust is the basis for long-run collaboration.

Contractual trust may initially be ascribed to family members, or people from the same ethnic group with whom the business person has mutual social obligations (Humphrey and Schmitz 1996). But business trust is gradually expanded over time as a result of the experience of continuously testing the trust. In unstable and risky environments, such as Africa, competence trust may be as important as contractual trust (Pedersen and McCormick 1999:122). Fukuyama (1995) goes further than Humphrey's and Schmitz's (1996) three elements and adds two levels to the issue of trust by laying out the advantages and disadvantages of what he calls 'high and low trust'. According to Fukuyama, the advantages of 'high trust' are: (a) lower administration costs, higher institutional, and reliability; (b) large and efficient organizations. On the other hand, the disadvantages of 'low trust' are: (a) corruption and trade with influence; (b) small and inefficient organizations.

The role of trust in the informal sector has been widely studied without any particular institutional framework in mind, thus presenting a scattered and rather disorganized image from various studies that do not make it clear why trust is a significant factor in the informal sector. This study echoes the argument that trust is an important informal institution (Fukuyama 1995; Bratton 2007; Hyden 2006) and subsequently frames trust under informal institutions. In order to present a clearer and more organized image the study analyses trust from two dimensions: social networks and business operations, which I further summarize, using two different illustrations (see Figures 1 and 2).

### ***Social Networks Dimension***

Fukuyama (1995) asserts that the personal and institutional networks are means of trust generation. Therefore, based on Fukuyama's assertion, networks of individuals and organizations are sources of trust. Social networks are known to typically offer accommodation and entry for the poor into the informal economy (Macharia 1997:x). But the informal sector not only accommodates the poor who are unable to find jobs in urban areas but also acts as what Kilby (1969:310) calls, a 'quasi-sponge' for the formal sector when urban unemployment in the wage sector increases due to surplus labour. In its 'quasi-sponge' role, the informal sector acts as a secure catchment area where the anger and frustrations of the urban unemployed, who constitute a significant destabilizing force in the political and economic realms of society, are effectively muted and converted into the energy for survival (Ninsin 1991:5). This is usually one of the processes that lead to an increase in social capital. Lyons and Snoxell (2005) note that traders consciously develop their marketplace social capital and dramatically increase

the number of people they feel they know well and can count as relatives and friends. In the formation of this new and valuable social capital, Putnam (1993, 1995) identified networks and trust as its essential components.

Due to the lack of formal institutions that undergird these networks, they tend to be mainly sustained through informal institutions, which have an important role in shaping human behaviour. Hyden (2006:83) points out that informal rules play an important role in constraining individual choice and behaviour and the informal rules may be more influential in determining human behaviour than formal ones. Based on existing evidence, which guides the analysis in this article, the main informal institution that seems to be prevalent in the social networks that exist in the informal sector is Trust, which is often described by means of the words 'obligation' and 'expectation/prediction' (Radaev 2002). This study uses the definition offered by Coleman (1988), who defines trust as 'a belief that the other agents would act in a predictable way and fulfil their obligations without special sanctions'. The importance of trust is dependent on the social structure (Coleman 1988). There are social structures in which people are always doing things for each other and social structures where individuals are more self-sufficient and do not have to depend very often on other people. Trust can be created in different ways. Höhmann and Welter (2004) make a distinction into personal, collective and institutional trust. Personal trust is based on initial knowledge about the partner and is formed in a long bilateral relationship where persons have come to know each other. Radaev (2002) calls trust in people reciprocal trust, probably because he shares the opinion of Höhmann and Welter that this form of trust is based on a bilateral relation. Höhmann and Welter (2004) mention shared characteristics of a group as another reason for personal trust.

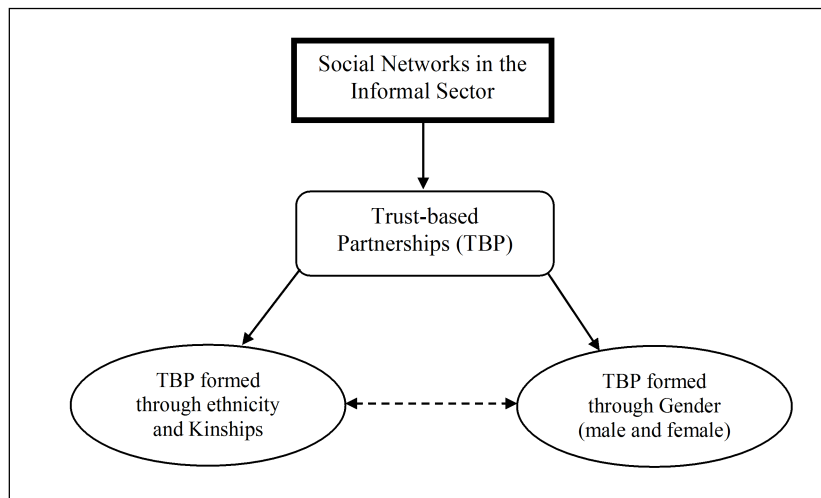
For the most part, informal institutions are usually maintained through interpersonal trust that actors have in the rules that govern the interactions they establish. Macharia (1997:xiii) notes that the concept of trust leads to the formation of social networks that later translate into social capital and real capital used to run the enterprises in the informal sector. In a study of the informal sector in Nairobi, which Macharia conducted in 1989, he interviewed 200 informal sector operators and found that trust was a very important concept among them, such that it forms an important basis of social capital among the entrepreneurs. Trust also plays an important role as a requirement for collaboration and networking in the sector (Pedersen 2001). Usually, entrepreneurs network to address issues including business management, pricing, marketing and searching for stock or capital. Alila (2001:338) points out that developing trust is a fundamental consideration



in the establishment and existence of small and micro enterprises in the informal sector.

When there is personal trust between two persons, they both know that the other will not act in a way that is damaging to the relationship. This is normally the result of informal norms and rules that dictate the actions that matter for the relationship. In a study on Iganga maize traders in Uganda, Sorensen (2001:305-306) found that in order to handle the intrinsic conflict between individual achievement and the common interest of the kinship group and the local community, traders follow advanced economic strategies in which they manipulate and negotiate the principles of both spheres through the creation of trust-based and trust-proven trading partnerships. These sorts of trust-based principles that facilitate partnerships play a significant role in filling the void that has been left by the non-formalization of the sector by governments. But even where governments try to use formal institutions to regulate the informal sector entrepreneurs tend not to trust them. Evidence from a study done in Chad found that entrepreneurs stay away from formal institutions because of the significant priority they place on trust-based partnerships arrangements (Sananikone 1996:108). According to him, the legal authority and regulatory framework has been biased against the development of small businesses, thus they have avoided interaction with formal institutions and turned either to other informal institutions for survival, such as informal sources of credit from what is known as tontines or to credit programmes provided by a small number of NGOs (Sananikone 1996:112).

Trust-based partnerships can be better understood by looking at some common factors that determine the formation of such partnerships. The two main factors that seem to be prevalent in existing evidence on informal sectors in Africa are: (a) Ethnicity and kinship, and (b) Gender. I use the illustration below to summarize how trust is used as an informal institution in the informal sector.

**Figure 1:** Social Networks Dimension

In Figure 1 above, the dotted arrow that runs from ‘TBP formed through ethnicity and Kinships’ to ‘TBP formed through Gender (male and female)’ indicates that some partnerships can be composed of members of characterized by the combination of the same gender and ethnicity.

**(i) Ethnicity and Kinship in Trust-Based Partnerships**

In African societies, ethnicity and kinship have been known to play an important role in the strengthening of trust among people from same communities or in the weakening of trust among people from different communities (Lyon 2005). These ethnic and kinship bonds subsequently determine how people interact with each other and the treatment that they accord each other as members of related families and kin in various spheres of life, whether it is within the private or public realm. In most cases, trust is stronger within people from the same kinship or families, who happen to be quite cohesive. Tripp (1997:11) points out that family and kin are important to cohesiveness of society in Africa, and African sociability is a key feature of the African social landscape. Apparently, due to the fact that most informal sector enterprises are family-based, (Webster and Fidler 1996:9) ethnicity has been one of the criteria that shape the interactions and relationships that exist in the informal sector, especially with the social networks that group entrepreneurs together with a goal of seeking to benefit jointly from various business operations. Based on a study done in the informal sector in Kenya, Macharia (1991) asserts that ethnicity is a key element in the operation of the social networks pervading the informal sector.

In a study done on informal sectors within twelve West African countries, in two phases – 1994 and 1995 – a team of eight researchers under the auspices of the World Bank found that the most common sources of credit for informal enterprises were kinship ties, especially family and close family friends, which frequently pool their incomes to create an effective social safety net for one another (Webster and Fidler 1996:15). In the study done on Kenya's informal sector, Macharia (1991) also found that ethnicity was a significant determinant in the transfer of skills, the allocation of informal business premises, acquisition of technologies, and most importantly, access to markets and customers. He particularly points out that whole sub-sectors of the informal sector in Nairobi are operated by specific ethnic groups which tend to perpetuate the entry of the same ethnic group members to any space for running a business or kiosk. In a different study done in 1997, Macharia (1997:124) found that entrepreneurs relied on trust to decide whether to give credit to their customers. There was strong evidence from his fieldwork showing that sellers trusted members of their ethnic groups more than customers from other groups and credit was usually advanced to co-ethnics.

Ethnicity has also been used as a criterion for how much one is trusted in rotating credit and savings organizations in South Africa, which are known as *stokvels*. Within these *stokvels*, ethnicity has also been used in establishing relations of trust with people of the same ethnic group. As a result, *stokvels* generate a strong sense of solidarity among members, taking on the functions of a provident society for those in need – not only for the member, but also for the family (Verhoeff 2001:272).

Somalia presents an interesting case in Africa due to the realities it has undergone as a stateless economy for so many years. The lack of a functioning formal legal system has made it impossible for Somalis to trade and engage in commerce in the formal sense, that is, trade facilitated and regulated through codified rules. Thus, as Little (2003) puts it, there is no distinction between official/unofficial, legal/illegal economies. Accordingly, the rules of the game are half observed by the public and half enforced by authorities (Little 2003). Due to the weak formal institutions, trade has always taken place under various informal institutions, especially trust. In his book *Somalia: Economy without State*, Little (2003) talks about social trust as the value that underpins informal trade in the country. In a way, Little (2003) echoes Fukuyama's (1995) assertion that no economy, no matter its nature or size, can function without social trust. In terms of ethnic groups, Somalia is one of the most homogenous countries in Africa with 85 per cent Somalis and 15 per cent Bantu-speakers and other non-Somali groups (CIA 2008). Although Somalia does not have an ethnically divided society as is in other

African countries, kinship ties play an important role in determining the way trade takes place. Working through a network of kin and marital relationships, Somali traders buy livestock on credit from herders (Mahadalla 2003). Little (2003) asserts that without trust the informal trade that takes place among livestock herders would have been impossible. Mubarak (1997) points out that Somali herders have historically provided credit directly to livestock exporters at the border between Somali and Kenya through negotiated agreements that have been made possible by the social trust that lubricates the wheels of livestock trade.

In a study done on how Ghanaian associations in the informal sector manage cooperation, Lyon (2005) examined how cooperation is sustained in the absence of strong legal institutions and mechanisms, such as legal contracts or regulated loan finance. The evidence from Lyon's study indicates that cooperation is based on trust and power, both of which are based on cultural specific norms. Lyon points out that in southern Ghana the norms of interaction vary with differences based on ethnicity. With regard to trust based on existing relationships and kinship, Lyon (2005) found that existing business relationships were mainly kin-based or community-based with members knowing one another well before they formed a group. Lyon's findings are in line with the argument that trust is an issue that builds up over time through frequent interactions, and reciprocal relationships (Coleman 1998; Radaev 2002). The table below summarizes what Lyon (2005) found when analysing the nexus between trust and kinship among various groups.

**Table 1:** The Role of Trust and Kinship in Various Groups within Ghana's Informal Sector

	<b>Susu savings Groups</b>	<b>Manual palm oil processing</b>	<b>Mechanized palm oil processing</b>	<b>Transport union branches</b>
Trust based on existing relationships and kingship	Community members knew each other. Traders have stalls next to each other over many years	Other members were neighbours and kin	Guarantees of supply to women processors from others community members. Staff attended the same church group	Introduction of new members by existing members

### ***Gender in Trust-based Partnerships***

Issues related to gender in the informal sector have been studied with respect to the different types of businesses that men and women decide to pursue in the sector. Apparently, both genders also seem to prefer different sorts of activities and ways of doing business. In a study of two markets in Kenya's informal sector, Lyons and Snoxell (2005) found that there is a clear gender boundary when it comes to savings and microfinance, especially within associations that are popularly known as 'merry-go-round' (MGR). The MGR is an informal rotating savings association (ROSCA), whose members deposit a mutually agreed sum with the group at regular intervals, the combined 'pot' going to each member in turn. Thus, the economic function of this group is generally not to accumulate income, nor to enable borrowing, but to guarantee the periodic availability of a capital sum, through peer pressure to save. Within this arrangement Lyons and Snoxell (2005) found that the development of MGRs is associated with the development of trust. It is trusted, for example, that members who draw from the pot early in the cycle, will continue to make their contributions to enable others to benefit, or that secretaries will not abscond. In savings and loan associations, four members rely on each borrower to keep up his loan repayments, because they all act as his, or her, guarantor. Most importantly, they found that most MGRs are often dominated by a single sex. Only one of the MGRs out of several of them is found to be composed of mixed gender. Otherwise, women and men have invited friends or acquaintances of the same sex to join. The administration of these groups is also approached very differently by women and men. For men's groups, regular weekly or bi-weekly collections are made and disbursed by a secretary and social contact takes place only at an annual social event, or on exceptional occasions, such as a funeral. In contrast, women's MGRs meet once a week or once a fortnight to make the collections, disburse them and discuss business conditions and personal lives (Lyons and Snoxell 2005).

The women in Cameroon's informal sector are also known to be active and successful in managing credit and finance issues within the trust-based micro-finance institutions, which are a sub-sector of the informal sector (Aye 2007). Just like in the stokvels in South Africa, the success of these women's operations have been mainly determined by the emphasis they put on trust as a way of filling the vacuum left by lack of formal institutions. In a study conducted by Mayoux (2001:435) on women's empowerment and micro-finance in Cameroon, she points out that the micro-finance programmes are dominated by the 'financial self-sustainability paradigm' where women's participation in groups is promoted as a key means of

increasing financial sustainability while at the same time assumed to automatically empower them. However, the process of empowering the women has been challenged by the complexities involved in power relations and lack of clear norms, networks and associations that are to be promoted. But amidst this confusion, there is optimism based on the understanding of the concept of social capital focusing on horizontal norms, networks and associations assumed to generate trust (Mayoux 2001:439). The role of trust in these associations has been the sharing of information, which is used in the micro-finance programmes to level asymmetries that may lead to increases in the costs of their operations and subsequent losses due to lack of formal institutions that make it possible to access information easily. Fafchamps (1999) notes that in Africa legal institutions offer little protection against breach of contract and the cost of searching for information and screening products and business partners is high, thus there is considerable potential for opportunistic behaviour and an incentive to deal with those one can trust.

In South Africa, during the 1980s, women entrepreneurs also established partnerships based on trust in *stokvels* – as noted, a type of rotating credit and savings organization, as they tried to fight traditional kinship factors that prevented African women from penetrating the informal sector. Verhoeff (2001:259) notes that traditional kinship relations denied African women access to property and cash income until the late 1990s, when changes started occurring. As women moved out of the rural to urban centres, women created opportunities for independent earnings, and displayed remarkable entrepreneurial spirit in undertaking economic activities. These *stokvels* are formed on the basis of voluntary association of mutually trusted parties (well-known and trusted friends, family, or neighbours of long standing), which require regular cash contributions (Verhoeff 2001:264). Since the *stokvels* lack formal institutions, the admission of members in the *stokvels* is based on trust (Verhoeff 2001:271). Trust is also the criterion that women have used to argue against the admission of men to the *stokvels*. Thus, there are *stokvels* with exclusively male membership and *stokvels* with exclusively female membership. Verhoeff (2001) found that when asked why they do not admit men, women often commented that men were not trustworthy.

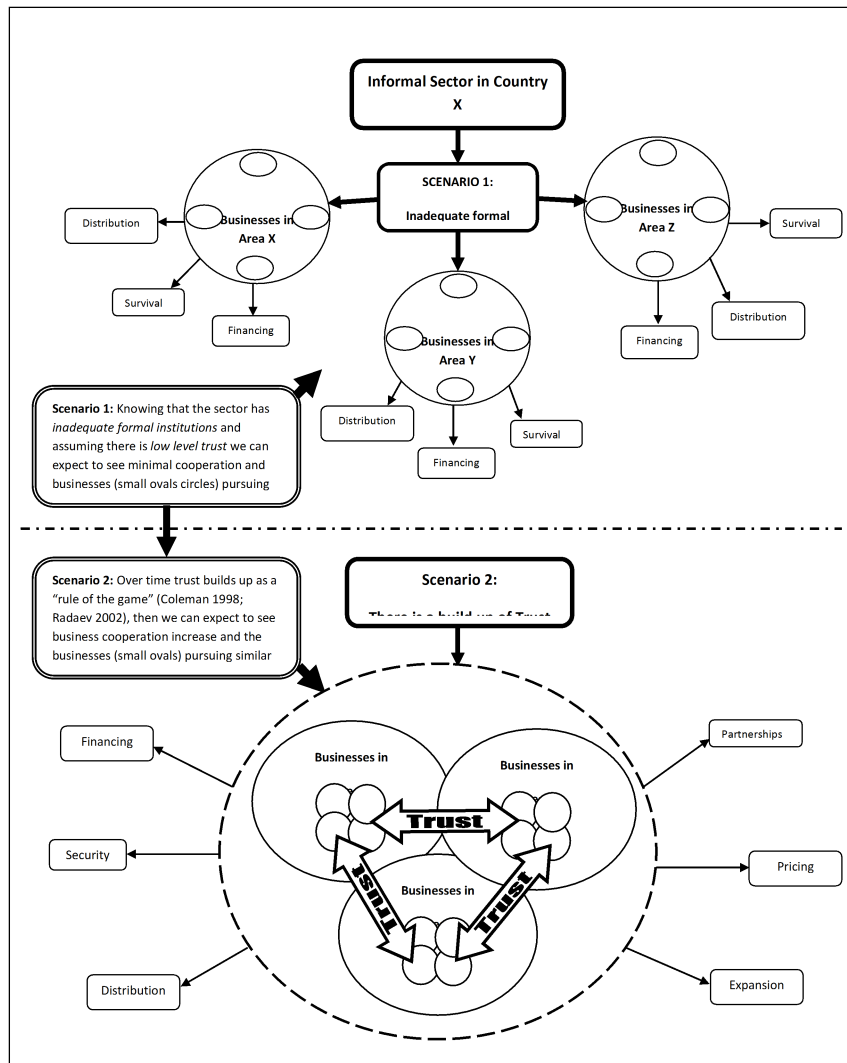
### ***Business Cooperation Dimension***

The informal sectors in most African countries are known to be the most diversified in the world when it comes to the types of business operations that entrepreneurs invest in (Kimuyu 1997). In urban areas, they range from street vendors to small manufacturing entities. In rural areas, small enterprises

engage in the production and sale of farm products, handicrafts and services. In short, the informal sector can be identified in activities of almost all types in the African markets: financial, labour, manufacturing, agriculture, etc., and services (UNDP 1996). Following Portes et al., (1989), informal sector trade operations can be defined as trade in legal goods and services, taking place outside the law. Working outside the law may include trading without a permit, trading outside formally designated trading locations, non-payment of municipal or national taxes, or self-provisioning of shelter. Moves between the 'formal sector' and the 'informal sector' are thus of various types. Hawkers are at one end of a spectrum of informal traders, with no formal shelter, often trading in undesignated spaces. At the other end of the spectrum are traders with established premises and licensed businesses in designated spaces (Lyons and Snoxell 2005). Thus, due to the shortage of resources in the sector cooperation is quite essential.

Typically, in the formal sector written rules – such as contracts – facilitate cooperation and help in the reinforcement of trust through creating an environment of predictive stability. As Fukuyama (1995) puts it, the trust producing ability of organizations depends on the rules within the legal system, which extend trust by the belief that the rules will be respected and applied as announced. But in the informal sector this role has been taken by the trust that builds up over time among traders and entrepreneurs. Therefore, with regard to businesses cooperating to achieve various goals, we can assume that there are two possible scenarios in the informal sector: (a) In scenario one, in which there are no adequate formal institutions and there is a low level of trust, leading to a lack of cooperation and pursuit of few goals because individual businesses only have minimal resources; and (b) Scenario two, in which the vacuum left by the lack of formal institutions has been filled by trust that has build up over time through reciprocity (Coleman 1998; Radaev 2002). In many ways, the reciprocal relationships that exist in the informal sector are similar to those that Hyden (2006) describes as the 'economy of affection'. Hyden (2006:84) argues that in the economy of affection the essence of rule of law is replaced by an interpersonal trust that is more immediate and exclusively reliant on unwritten rules in use. Within an expansive regional context these interpersonal reciprocal relationships can increase through networking and be conceptualized as, what Putnam calls, 'social trust' (1993:171) points out that social trust can arise through norms of reciprocity and networks of civic engagement. The build up of trust may subsequently lead to an increase in cooperation within extensive business networks and the pursuit of more goals that eventually increase productivity. Figure 2 illustrates the two scenarios.

**Figure 2: Business Co-operation Dimension**



Based on the argument I make on how trust facilitates business cooperation, which I have illustrated using Figure 2, this section uses three cases from Zimbabwe, Nigeria, and Kenya as evidence of how trust facilitates cooperation among businesses on three issues: financing in Nigeria, survival strategies in Zimbabwe during uncertain political periods, and in the distribution of goods among traders in Zimbabwe and Kenya.



Trust has been instrumental in determining the types of business ownership that exist in the informal sector. In the formal sector legal mechanisms such as contracts, registration forms and ownership certificates help in the establishment of various types of partnership (Eeekhout 2006); hence making it possible for two or more friends or relatives to enter into a partnership and own a business together. This is not to say that trust does not play a role also, instead trust becomes a low level criterion for deciding whether to enter into a partnership or not. But in the informal sector these legal mechanisms do not exist for the most part and use trust as a high level criterion to decide whether to enter into partnerships or not. From a survey done in Lagos, Fapohunda (1985:30) concluded that partnerships form a small proportion of all establishments due to mutual distrust among entrepreneurs in business undertakings within the informal sector. In his study he found that informal sector enterprises in Lagos were predominantly a one man business. Out of 2,074 establishments that were covered in the survey, 92.6 per cent were single proprietorships, seven per cent were partnerships, about 0.3 per cent were private Nigerian or public limited liability companies, and almost 0.2 per cent said they were of other type of ownerships different from any of the three stated above.

Nigeria's informal sector is also similar to Ghana's in terms of size and the difficulties encountered in measuring the sector (Ekpo and Umoh 2008). The activities that take place in the sector are highly dynamic and contribute substantially to the general growth of the economy and personal or household income. Within the informal sector of Nigeria the financial sub-sector is the most difficult to measure due to its underground nature. The activities of this sub-sector are mostly underground, unofficial, irregular, informal, shadowy, and parallel. The most predominant type of underground informal finance in Nigeria is the *Esusu* (Ekpo and Umoh 2008). The general practice is that *Esusu* associations contribute a fixed amount periodically and give all or part of the accumulated funds to one or more member(s) in rotation until all members have benefited from the pool. The *Esusu* associations are characterized by both formal and informal institutions. Ekpo and Umoh (2008), note that some *Esusu* groups operate with written laws, while others operate with unwritten laws but on oath of allegiance and mutual trust.

In Zimbabwe, trust played a significant role in the survival of urban street vendors in the informal sector during 'Operation Murambatsvina', in which President Mugabe's regime attempted to wipe out the urban street vendors, who were usually supporters of the opposition. Mugabe's government perceived the urban street vendors as culprits that have been the principal cause and engineers of the dirt in the city (Chirisa 2005). However, due to its dynamic nature the informal sector has not disappeared.

Instead it has assumed a different form and continues to operate in clandestine ways. In a study of the informal sector after Operation Murambatsvina, Chirisa (2005) summarizes the new form it has taken as follows:

Shop fronts everywhere in the city are littered with informal traders of various goods and services like carrier bags, locks and keys, food items, etc. Competition is rife in the sector. Newcomers not trusted in the sector find it difficult to establish themselves in established locales, as the 'conscriptio' is watertight. Tolerance by shop owners is a wide phenomenon. Foreign currency dealership is one of the lucrative ventures for some. As one moves around Fourth Street and Africa Unity Square, he or she may hear the 'hiss' by the dealers attempting to attract trade with passers-by. Airtime phone cards are now sold from the pocket.

Evidently, trust plays a significant role in maintaining the operations that exist under the aforementioned forms of clandestine operations, which are mainly made possible by trust-based partnerships. The partnerships reflect a deliberate alliance where all parties work harmoniously in bringing permanent positive change. Chirisa (2005) points out that these partnerships are mainly built through trust. As partnership builds up, more and distant partners will be brought in and the web widens. In a study of two markets in Nairobi, Lyons and Snoxell (2005) found that some new traders who want to survive in the informal sector, by extending their partnerships, usually set out to make friends based on trust in their new marketplace directly in order to support their trading activities. This is used as a way to learn about suppliers, find trustworthy colleagues for the exchange of necessary favours and manage competition.

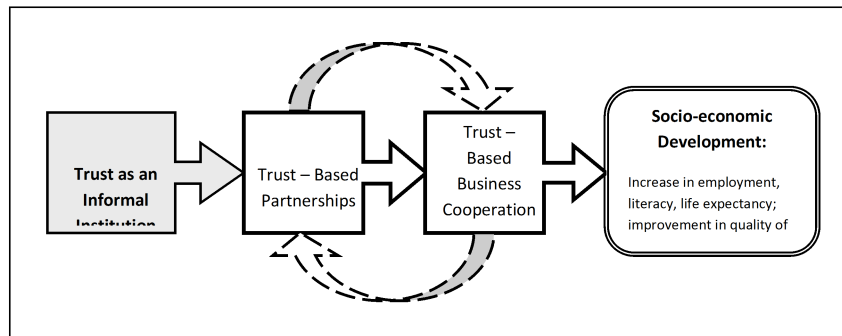
In widening the web with distant partners in the operations that take place in the urban sector the status of the infrastructure matters significantly, given that goods have to be transported from one trader to another. But in many African countries the existing infrastructure is overloaded and in bad state, while services are unreliable and often expensive and infiltrated with corruption. The poor infrastructure thus impedes the ability of small traders to move goods back and forth to each other. Therefore, in order to be successful, they have to rely on wholesalers and trading agents to ferry the goods, but with no binding contracts. In place of the contracts, they are forced to use trust as a criterion for determining which wholesalers and traders will ferry the goods. In many African countries, monopolistic or illicit tendering practices and the inability of the legal system to secure enforcement of contracts is a major problem, especially for small and medium-sized enterprises (Fafchamps 1996; Kimuyu 1997). Therefore, they need to base their business relations on mutual personal trust. In Kenya, for

instance, Asians control most of the wholesale sector, and in Zimbabwe the dominance of large retail chains operating as their own wholesalers means that an open wholesale sector has failed to emerge. As a result, small and medium-sized producers are forced to develop their own distribution system if they want to expand beyond a very local market. Some travel themselves, using the public transport system, while others build trust based relationships with mobile traders who transport their goods for them (Pedersen and McCormick 1999:122).

### **Conclusion**

At this point of the analysis, one important question that remains to be answered is: What are the developmental implications of the trust-based partnerships (TBP) and trust-based business cooperation (TBC) that keep the informal sector going? This final part will only attempt to respond to the question briefly and hypothetically. Perhaps, a comprehensive and thoroughly researched response will be offered after the field research for this study has been carried out. The question, therefore, also serves as a point of departure. The prevalent concern that seems to be evident in most of the studies that have been done on the informal sector seem to revolve around the relationship between the informal sector and socio-economic development (for example, Alila 2001; King 2001, and Portes 1999). There are some studies that have tried to address the role of the informal sector in development (Fapohunda 1985; Ninsin 1991, and Little 2003). There are also some studies that look at external factors, for instance political, that affect the business operations that take place in the informal sector (Ayee 2007; Kimuyu 1997, and Tripp 1997, etc.) and finally there are studies that look at the factors that make it possible or impossible for the informal sector to contribute to socio-economic development (Fafchamps 1999; Verhoef 2001, and Billetoft 1996). This study falls more appropriately into the latter category. I argue that trust as an informal institution plays a significant contributing role in socio-economic development by: (a) making it possible for social trust-based partnerships to exist through social networks, and (b) making it possible for business cooperation to take place in the informal sector, thus possibly leading to increased productivity. A causal relationship – subject to empirical research – can therefore be modelled, where trust as an informal institution is the independent variable; trust-based partnerships and trust-based business cooperation are intervening variables, and socio-economic development the dependent variables. Figure 3 illustrates this hypothesized causal relationship.

**Figure 3:** Possible Relationship between Trust, TBP-TBC, and Socioeconomic Development



In Figure 3, I use the two arrows going around trust-based partnerships (TBP) and trust-based business cooperation (TBC) to suggest that the difference between TBP and TBC is possibly a matter of stages that are constantly going on in the informal sector like an endless loop. In the causal relationship that I hypothesize above the difference between partnerships and cooperation is that partnerships capture the initial stages that exist in joint operations within one business, which are characterized by members of the same ethnic group, kinship or members of the same gender, and small scale operations. On the other hand, business cooperation goes beyond the ethnic, kinship, and gender boundaries by expanding small scale operations to large scale operations among different ethnic groups, members from different kinship groups, and between both men's and women's associations. This second stage is made possible by the long-term build up of trust among entrepreneurs. These two stages can be appropriately explained by what Fukuyama (1995) calls 'low and high trust'; low trust being evident in partnerships and high trust in business cooperation. Therefore, after partnerships have been formed at the lowest levels, the businesses in the sector may be more inclined to cooperate at higher levels on various issues so as to benefit from the advantages of high trust, such as lower costs in the distribution of goods and in securing their businesses.

If the above causal relation is true, then we can also expect to see socio-economic development gradually taking place. The appropriate way for measuring the informal sector's contribution to development is under the framework of socio-economic development, which is much broader than the concept of economic development alone. Socio-economic development involves a wide range of changes in a variety of social indicators such as health, education, technology and life expectancy, which are directly or

indirectly linked to economic changes (Zirmai 2005). The final output from the trust-based business cooperation – as argued in this article and also in line with ‘high trust’ (Fukuyama 1995) – is an increase in productivity, due to the large and efficient organization structures that we should expect to see in the informal structure. The positive spill over effects of this productivity, whether at the single business level or at the partnership level in the informal sector, is its contribution to socio-economic development in the long-run. For, example, when it comes to employment, micro enterprises – which form the largest category within the informal sector (Sandefur and Teal 2007) – make a higher contribution than the formal sector.

Micro enterprises make an important contribution to economic output and employment in developing economies. While estimates vary greatly depending on definitions, recent work by the World Bank suggests that almost 30 per cent of employment in low-income countries is generated by the informal sector, while an additional 18 per cent is provided by formal small and medium enterprises (Sapovadia 2006).

Both in the past and recently, some scholars (for example, Billetoft 1996; Fafchamps 1999; Ayee 2007, and Eeckhout 2006) have argued that African governments should formalize the informal sector if they want to increase tax revenues, which can be added to government budgets for the purpose of financing national development initiatives. These are certainly noteworthy recommendations that need to be seriously considered. However, given that most African governments are still not trusted by traders and entrepreneurs in the informal sector (Ayee 2007; Chirisa 2007), it may also be important for governments to cautiously embrace and implement these recommendations with respect to the socio-economic development role that trust, as an informal institution, plays in the sector. In this regard, the most important issue that needs to be understood is the effect that formal institutions – which are not effectively enforced in Africa (Hyden 2006; Billetoft 1996; North 1990) – will have on the role of trust in facilitating partnerships and business cooperation, both in the short and the long run. While making this suggestion, I am aware that even in business operations that take place under formal institutions, trust still plays a fundamental role (Fukuyama 1995).

As a point of departure for this study, I have hypothesized a causal relationship between trust, trust-based partnerships, trust-based business cooperation, and socio-economic development that can be researched to increase our understanding of the possible effects of formalizing the informal sector. Such a study can be done by replacing trust, which is the independent variable, with a formal institution, for example, contracts, and comparing

the results of the new scenario (under contracts) with the former scenario (under trust) using some socio-economic development variables. In the short-run, I tenuously speculate that there will be turbulence and some negative results. On the other hand, my tenuous speculations for long-run results range from uncertainty to some positive results. In sum, as Mhone (1996:110) points out, 'the informal sector needs the application of more rigorous research tools and methodologies for its understanding and efficient support, promotion and integration; the task is to deploy these tools more systematically to the investigation and understanding of the informal sector'. This should be the future thrust of the work that needs to be done in the sector by social scientists from diverse disciplines.

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