

POLICY BRIEF

JACQUELINE BOREL-SALADIN and IL-HAAM PETERSEN | DECEMBER 2022

Boosting innovation in small informal businesses through collaboration

Introduction

Small businesses in the informal economy drive employment, but they struggle to thrive.¹ They are particularly vulnerable to shocks due to major events such as the Covid pandemic. A recent study by researchers at the Human Sciences Research Council shows that innovation can help these businesses survive and grow.² For informal businesses, working with other businesses and innovation support organisations, such as finance providers and training organisations, can grow more opportunities. In informal local settings such as township economies, these linkages are often weak or missing, and connections are difficult to establish. This policy brief considers how to increase informal business interaction within local networks, which is crucial for innovation that contributes towards the sustainability and growth of informal businesses, and potentially their transition to stable, formal micro-enterprises.

Interaction within Local Innovation and Production Systems is Crucial for Informal Business Innovation

Innovation in informal businesses depends on interaction with a range of actors, from suppliers to distributors, workers and consumers, but also organizations involved in training, R&D, support, regulation and finance providers, both in the formal and informal sectors.³ Occurring mainly at the local level, the linkages may be formally regulated but are more often informal in nature.⁴ The nature and scale of this interaction is well captured using the lens

of a local innovation and production systems (LIPS) framework. Using the LIPS framework, the focus is not on one business, but rather, on all of the actors interacting around related production activities. The LIPS also draws attention to the policy environment and socio-economic characteristics of a local area, such as access to basic services and social dynamics, which impact on informal economic activity.⁵

Data from the 2017–18 Innovation in the Informal Sector (IIS) Survey and semi-structured interviews were used to study the linkages and interactions of informal businesses in Msunduzi, KwaZulu-Natal (KZN). A key finding of the IIS study is that the innovation capabilities of an informal business can be strengthened through interactions with other role players in a LIPS.⁶ This finding is corroborated by other research on innovation in micro and small businesses in South Africa showing that the businesses that innovate more tend to be part of broader networks of actors.⁷ Other benefits of interaction include reduced costs and risks of innovation, and improvement in innovation outcomes e.g., by sharing human resource and equipment costs, and developing new products with collaborators, etc.⁸

As figure 1 demonstrates, the lowest interaction strength occurs between the informal business and public sector actors including government and with universities, and few have linkages with financing actors, whether formal or informal (red arrows in the top portion of diagram).⁹

¹ ILO, 2019

² CeSTII, 2021c; Mustapha, Petersen, Kruss and Van Rheede, 2022

³ Petersen and Kruss, 2021a

⁴ CeSTII 2021a and b

⁵ Cassiolato and Martins Lastres, 2020

⁶ CeSTII 2021a and b

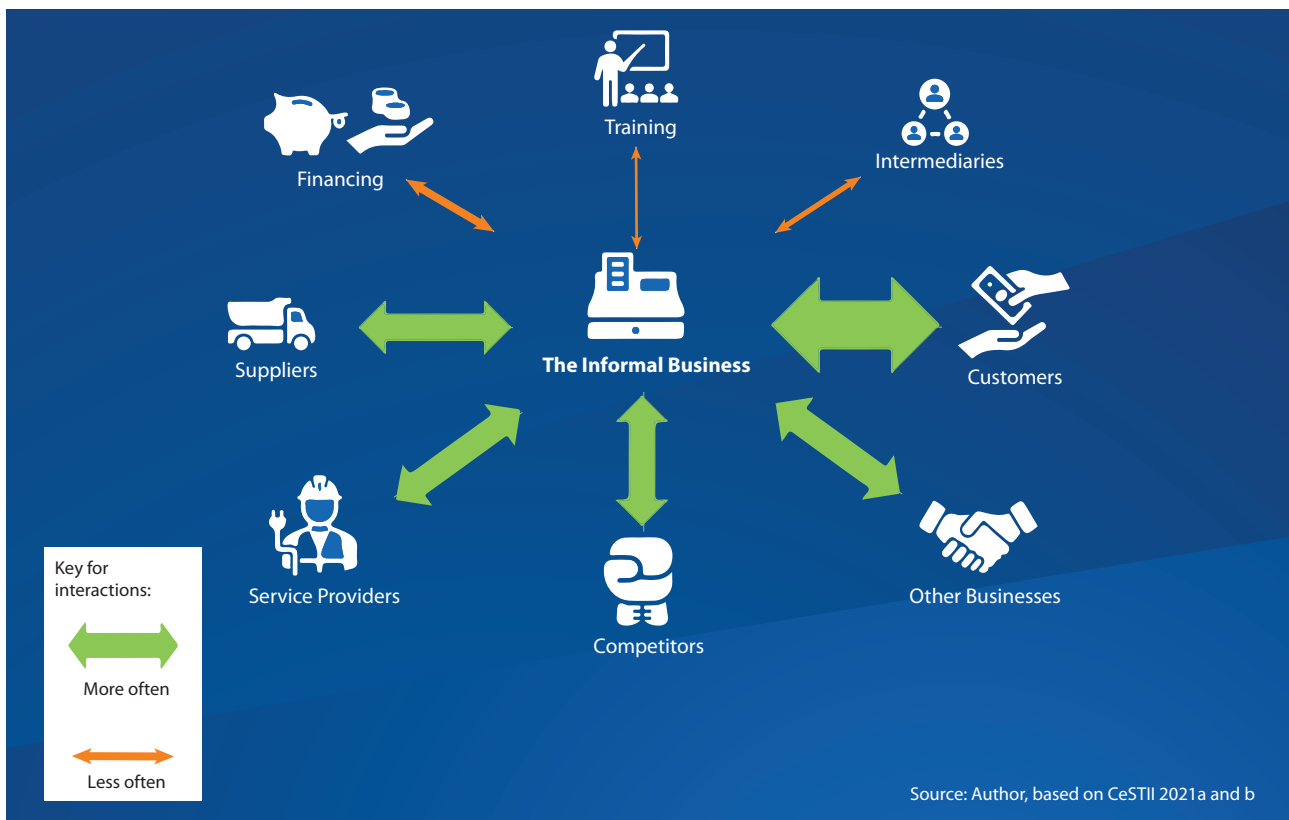
⁷ Bolosha, Sinyolo and Ramoroka, 2022

⁸ Lu and Yu, 2020

⁹ Figure 1 is a simplified diagrammatic representation of the relationship between the actors typically included in a LIPS, focusing on interaction strengths between players. The diagram also does not detail the various kinds of players, both formal and informal, that fall under each of the categories of actors.

The strongest interactions on average take place between the informal business and its customers, and with other actors in the production value chain, such as similar businesses and competitors (green arrows in the middle and bottom portion of the diagram).

Figure 1: Interactions between the informal business and other agents in the Local Innovation and Production System (LIPS)



Improving Informal Business Interaction in Local Innovation and Production Systems

A range of government programmes exist to help small businesses to access formal finance and training institutions and other support organisations. However, many of these initiatives do not apply to the majority of informal businesses, which are not viewed as “formal enough” to qualify. For example, they are not tax or VAT registered, export-oriented, or well-established or sophisticated enough to provide detailed long-term financial statements and business plans. Access to government assistance programmes outside of the metros and bigger towns is also questionable, as interventions may not reach into peri-urban and rural areas.¹⁰ One approach to promote informal business innovation is to support them to link more effectively with the formal actors in their local innovation and production system.¹¹ For example, local and provincial government initiatives can support the work of NGOs and other intermediaries to apply for suitable finance options and informal business support programmes offered by the national Department of Small Business Development.

Also, informal business innovation tends to be driven by necessity and often involves imitation of other local businesses.¹² The most frequent innovation activities in the informal sector result from local learning and capability building. Unsurprisingly, informal businesses turn mainly to their customers and suppliers, and to a lesser extent, their competitors and other informal businesses as sources of information for their innovation activities. Therefore, in order to strengthen the innovation capabilities of informal businesses, another approach is to focus on improving the learning potential of these businesses. This can be done through greater linkages across the local production value chain, with both informal and formal businesses, and with colleges, universities and private training organisations in the local area. NGOs may also offer tailored training programmes or serve as intermediaries in supporting informal businesses to access initiatives offered by colleges and universities.

¹⁰ CeSTII 2021a and b

¹¹ Mustapha, Petersen, Kruss and Van Rheede, 2022

¹² Petersen and Kruss, 2021a

Policy Recommendations

Supporting small economic units should be a central part of South Africa's economic and social development strategies. Facilitating interaction and linkages between informal businesses and other role players in local innovation and production systems can improve the learning capabilities required for informal businesses to innovate more effectively.

One way to do so is to maximise local interactions between informal businesses and other businesses playing a role in the same or related production value chains. Innovative informal businesses offer affordable goods and services to low-income customers. In turn, collaborating businesses can grow their customer base, helping each other to expand. As part of a bigger system of businesses providing interlinked services or goods, these informal enterprises can become more sustainable potentially. Another outcome of improved interactions and linkages among businesses is the development of co-operatives. This is especially important, given the resource-poor environments informal businesses operate in.

National government has several departments and agencies dedicated to small business development. Agencies such as the Small Enterprise Development Agency (SEDA) and the Small Enterprise Finance Agency focus on specific sectors and "up-skilling" entrepreneurs and business owners as well as providing them with financing and access to infrastructure such as information and communications technology (ICT). Initiatives, such as the Township and Rural Entrepreneurship Programme (TREP) under the auspices of the Department of Small Business Development, could include the facilitation of interaction among informal businesses as a channel of intervention.

Actors that are intrinsically locally focused are arguably best placed to facilitate greater interaction among the informal businesses in a given area. This includes actors that are active in the community and have relationships there, such as local NGOs. Potential interventions could include organizing networking days or initiating WhatsApp and Twitter groups or Facebook pages for businesses in various sectors. NGOs might also help identify champions and co-ordinate linking more experienced business owners and operators with newcomers who need mentoring, coaching and guidance. Other local intermediaries like local government and South African Local Government Association (SALGA) could play a facilitating role by providing venues and other resources for networking and collaboration events, such as access to community halls or sponsoring of innovation/small business hubs. Local business chambers could help to establish co-operatives among informal businesses in the area (perhaps in collaboration with something like the

COOPS programme through SEDA) and create and curate a local informal small business registry.

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