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Sector focus: The informal sector

The informal sector is a crucial and often overlooked part of Cape Town's economy. The use of the term 'informal' often conjures up images of survivalist street traders operating on the side of the road. However, the notion of 'informality' refers more to the conditions of work than to any specific type of economic activity, and should not be taken to imply discreteness from the rest of the economy. As this chapter will show, the informal sector incorporates a broad spectrum of economic activities and business typologies in a diverse range of geographic locations across the city, with varying intensities of relations with formal business. While Cape Town's informal sector may be relatively small, especially by emerging-country standards, its penetration into the most vulnerable households in the city and its impact in terms of poverty reduction are disproportionately large.

OVERVIEW OF THE INFORMAL SECTOR IN CAPE TOWN

The informal sector is commonly understood to refer to the unregulated, non-formal portion of the market economy. Statistics SA (2015) uses an employment-based definition for the sector, defining it broadly as comprising of employees working in establishments employing less than five employees who do not pay income tax, as well as own-account workers whose businesses are not registered for either income tax or value-added tax. The use of the term 'informal economy' is often preferred to 'informal sector', as it conveys a broader sense of the scope of economic activities that take place informally. At the same time, however, it may erroneously create the impression that the informal economy exists in isolation from the formal economy. For the sake of continuity with previous editions of *EPIC,* this chapter will use the term 'informal sector'.

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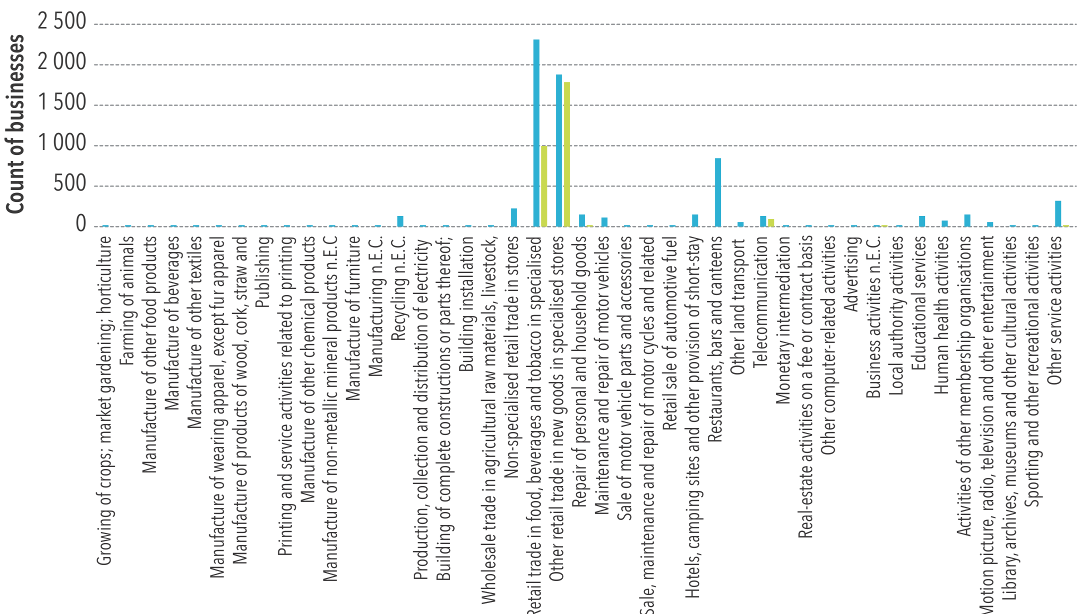
Scope of informal-sector activity: More than just trading

Devey and colleagues (2006) note that the informal economy is often marginalised, or sometimes even considered as a 'sector' on its own. In reality, however, the informal sector exists both together and co-dependently with the formal economy (Devey *et al*. 2006). As such, it is more appropriate that informal activities (as they exist on a spectrum with formal activities)[13] are considered in conjunction with formal activities as part of a common overarching economy (Devey *et al*. 2006). The formal

Figure 34: Informal businesses organised by standard industrial classification (SIC) codes



Source: City of Cape Town, 2015b.

13. This chapter draws entirely on the Informal Economy Development Study undertaken by the City of Cape Town between 2014 and 2015.

sector is typically categorised according to the standard industrial classification (SIC) codes, which broadly identify 44 industries in the economy. If informal economic activity is to be viewed in conjunction with formal activities as part of a holistic economy, it follows that informal-sector activity should also be categorised using the SIC codes. Figure 34 categorises informal-sector businesses according to SIC codes, using the results of a rapid appraisal of informal businesses based on existing township informal business databases and the City of Cape Town's own informal-trader permitting database.

Within Cape Town, 41 of the 44 SIC categories are represented in the formal sector, while 37 are represented in the informal sector. Predictably, the categories that are not represented in the informal sector, but are represented in the formal sector, are those that require large capital outlays, such as the mining of metal ores, water transport, air transport, telecommunications, and research and development. These categories aside, the informal economy is represented in a very diverse array of economic activities, from financial services to health care. As indicated by figure 34, however, informal economic activity is disproportionately clustered around the tertiary sector, especially retail and repairs.

The data used for figure 34 are likely to be biased toward retail trading, as these types of businesses are almost exclusively captured on the City's permitting database and, due to their visibility, are also most commonly picked up in non-representative surveys. However, when utilising representative survey data from Stats SA's QLFS, a less concentrated picture of the informal sector emerges. According to the QLFS, while almost 40% of informal-sector workers are employed in wholesale and retail businesses, significant proportions also exist in manufacturing (10,2%), construction (13,1%), financial services (10,9%) and community services (16,9%).

The informal economy is represented in a very diverse array of economic activities, from financial services to health care. However, informal economic activity is disproportionately clustered around the tertiary sector, especially retail and repairs.

Characteristics of informal-sector employees

The first column of table 6 shows the composition of informal-sector employment, namely the demographic characteristics that feature most prominently among the informally employed. The predominant groups participating in the informal economy in Cape Town are African (49%), male (60%) and prime-aged (41,1%). In terms of skills distribution among informal-sector workers in Cape Town, and using years of completed education as a proxy, the largest group is those who have some secondary schooling but have not completed their matric, at 43%. The second-largest group (27%) is made up of people with matric only. Together, these two groups account for 70% of informal-sector workers, which implies that work in the informal sector is relatively unskilled.

From a spatial perspective, about one in 12 people living in informal areas are found to be employed in the informal sector, with the rest living in areas defined as formal. This may initially come as a surprise, because informal settlement patterns are often linked to a higher incidence of informal work. However, this can be explained by the population effect, namely that since many more people reside in formal areas, they are likely to constitute the largest proportion of informal workers. For this reason, it is also important to look at the informal employment rates among different demographic and spatial groupings. In this respect, urban informal dwellers (8,0%), as intuitively expected, have a higher informal-sector employment rate than urban formal dwellers (5,0%). Similarly, although the largest number of informal-sector workers is found to have less than a secondary education (43,3%), the highest employment rate in the informal sector is actually among those with no education (16,9% compared to 5,2% for less than secondary). In fact, there seems to be an inverse relationship between the employment rate in the informal sector, and education.

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Table 6: Composition of informal sector, and employment rates in the informal sector (QLFS 2012:1 – QLFS 2014:2)

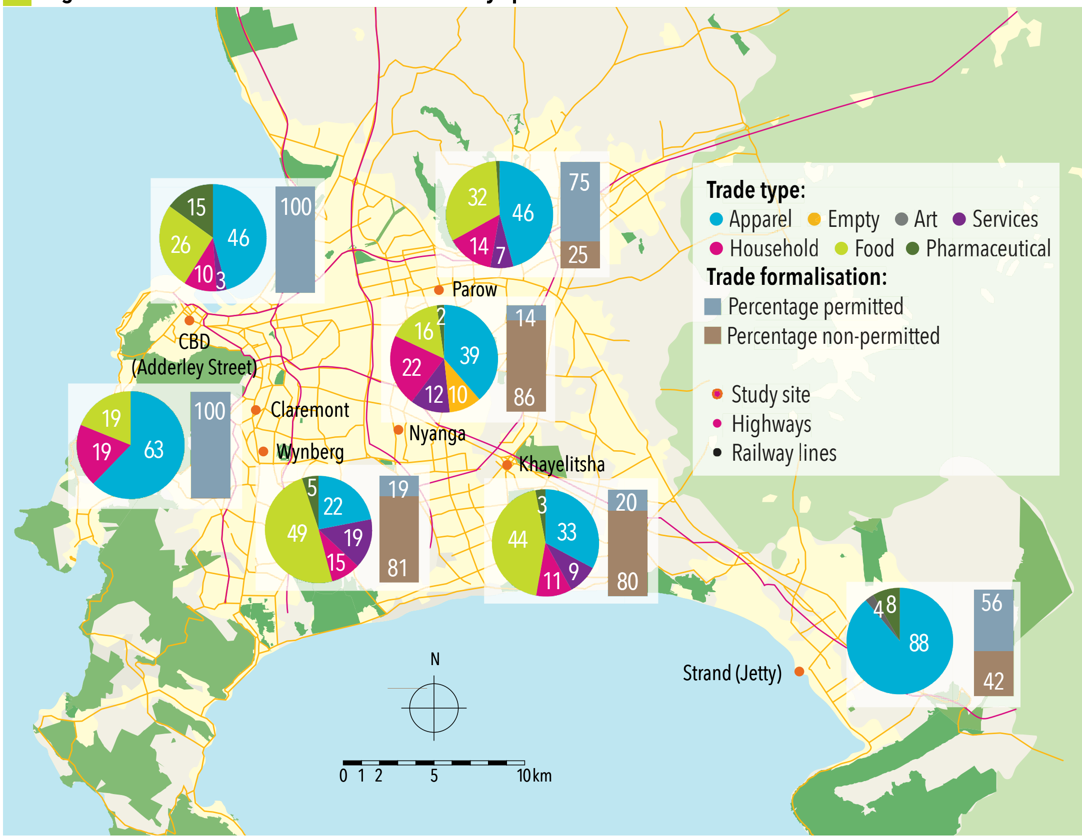
	% informal-sector workers	Employment rate in informal sector (%)
Gender		
Male	59,8	6,4
Female	40,2	4,1
Race		
African/black	48,5	6,9
Coloured	36,0	4,1
Indian/Asian	0,5	3,9
White	14,9	4,6
Age		
Youth (15–29 years old)	26,5	3,5
Almost youth (30–34 years old)	14,5	6,1
Prime (35–49 years old)	41,1	7,0
Older (50–64 years old)	17,9	5,2
Education		
None	3,0	16,9
Less than primary	8,2	7,2
Primary	5,4	6,1
Less than secondary	43,3	5,2
Matric	27,1	4,8
Some tertiary	10,4	3,7
Other	2,6	9,3
Spatial location		
Urban formal	88,2	5,0
Urban informal	11,8	8,0
Tribal areas	0,0	0,0

Source: City of Cape Town 2015b.

Spatial trends of the informal sector in Cape Town

Figure 35 below presents the findings of a survey of over 200 informal trading enterprises along transport corridors and business nodes across the city. Of particular interest is the extent to which informal businesses are permitted according to the City's informal-trader permitting system, and the type of goods that are traded at the different sites. The differences in goods traded points to area-specific product specialisation. For instance, the focus of trade at the Strand jetty is clothing apparel and accessories (compared to the Khayelitsha taxi rank, where locally manufactured clothes are sold), while the focus of trade at Wynberg Station is food.

Figure 35: Characteristics of informal traders by spatial location



Source: City of Cape Town, 2015b

The traders identified can be broadly divided into general (who rely on high-volume, low-margin sales) and specialised (who sell higher-margin items to smaller numbers of customers).

The traders identified in each of the selected areas can be broadly divided into two categories, namely general (who rely on high-volume, low-margin sales) and specialised (who sell higher-margin items to smaller numbers of customers). General traders are more responsive to pedestrian flows, as customer convenience is their main competitive advantage, while specialised traders specifically attract customers to them. Specialised traders, such as seamstresses at the Khayelitsha Site C taxi rank, operate in a market that is unique and suffers minimal competition with textile imports. Such activities have important local economic development potential. Generalised traders mainly function as retailers selling cheap and popular items, such as fruit, vegetables and snacks. This distinction implies that a one-size-fits-all approach to informal-trading management may be ineffective. While clustering of traders can be beneficial to specialised traders, who create their own pull factor (such as the Adderley Street flower traders), it tends to be harmful to general traders, who directly compete with each other on price and convenience.

SIZE AND IMPACT OF THE INFORMAL SECTOR IN CAPE TOWN

Employment in the informal sector

Census 2011 estimated that 122 013 people (or 9,44% of the total city workforce) were employed in the informal sector in Cape Town. This was substantially higher than the 2001 Census figure of 47 020 (5,01% of the workforce), although there may have been an element of measurement error in the 2001 figure. While Census figures provide an 80%+ sample of the population, they are not specifically geared toward measuring the labour market, and are outdated. Instead, Stats SA recommends that the QLFS, which is representative at the metro level, be used to estimate employment figures. According to the QLFS, the average number of people employed in the informal sector between the first quarter of 2011 and the second quarter of 2014 was 145 315, which is equivalent to 10,09% of the city's workforce. A more recent yet volatile estimate is the QLFS estimate for the second quarter of 2015, which finds 161 000 (11,3% of the workforce) employed in the sector. If the informal sector were to be viewed as a conventional economic sector, based on the more conservative estimate of 10,09% of the workforce, it would be the fifth-largest employing sector in the city, just below manufacturing (11,96%) and just above construction (9,52%). This attests to the sector's importance as an employer in the Cape Town economy.

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Table 7: Employment and wage estimates for the informal sector in Cape Town

Data source	Total employment in the informal sector	% of total employment in the informal sector	Mean wage in the informal sector (rand)	Reduction in the poverty rate
Census 2001	47 020	5,01	–	–
Census 2011	122 013	9,44	1 601–3 200	–
QLFS 2011:1–2014:2	145 315	10,09	–	–
General Household Survey 2013	185 984	11,84	3 432	4,5%, or 186 000 individuals
QLFS 2015: 2	161 000	11,30	–	–
Survey of Employers and Self-Employed 2013	–	–	3 300	–

Source: City of Cape Town, 2015b.

Impact of the informal sector on poverty

The socio-economic impact of the informal sector is even larger than what its contribution to employment would imply, as the income received from informal work accrues disproportionately to households that are close to the poverty line. Mean wages in the 2013 General Household Survey (GHS) are estimated at R3 432 per month, while the 2013 Survey of Employers and the Self-Employed (SESE) estimated a combined mean value of informal-sector wages and profits of about R3 300 per month.

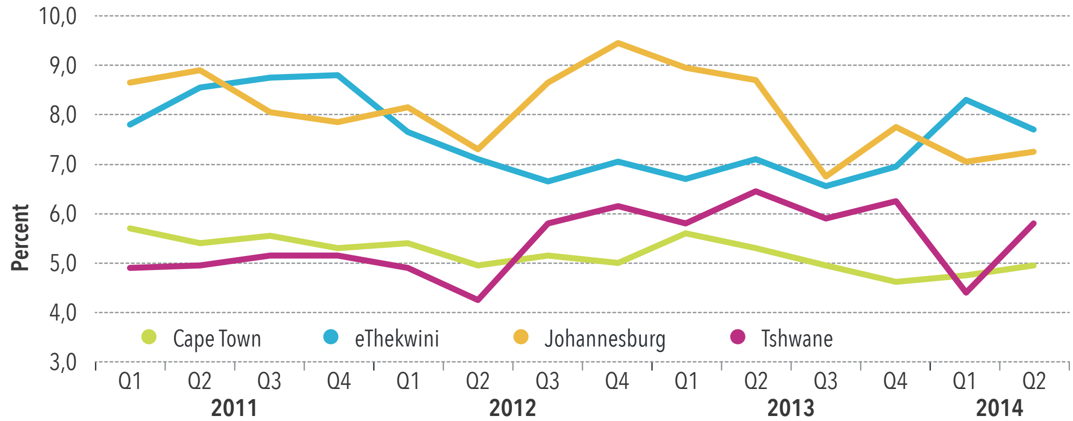
The impact of informal-sector income on otherwise impoverished households is measured using the GHS wage and household income figures. The relatively low wages of informal-sector workers, who tend to reside predominantly in poor households with a larger-than-average household size, result in a substantial decrease in the city's poverty rate. Without informal-sector income, the poverty rate in the city would be 25,1%, but once informal sector income is taken into account, the poverty rate is reduced to 20,6%. This 4,5 percentage point reduction in Cape Town's poverty rate is equivalent to pulling 186 000 people out of poverty. This would suggest that although the aggregate contribution from this sector to GDP may be small, the aggregate improvement in well-being is large.

TRENDS IN INFORMAL-SECTOR EMPLOYMENT IN CAPE TOWN

Historical employment trends

Figure 36 below compares the proportion of the working-age population who have been employed in the informal sector in different metro areas over the past four years. At the very outset, it is clear that a substantially higher proportion of the working-age population of both eThekwini and Johannesburg are employed in the informal sector. Neither metro has a significantly larger overall employment rate than Cape Town, so this reflects a larger proportion of their workforce being informally employed rather than better employment outcomes more generally. Another observation from figure 36 is that the proportion of informal-sector employment shows a declining trend in all metros except Tshwane. If the overall unemployment rate is static or decreasing in this period, the implication may be that formal-sector employment is increasing at the expense of informal employment.

Figure 36: Proportion of working-age population (15-64) employed in informal sector, by metro (QLFS figures)



Source: City of Cape Town, 2015b.

Transition rates and barriers to growth

To better understand the dynamic changes in informal-sector employment over time, it is useful to look at transition rates between the informal sector, formal sector and unemployment. This analysis supports the findings above, which seem to indicate that there is a strong movement between the formal and informal sectors as economic opportunities change over time. More than two out of every five people in the informal sector were no longer employed in this sector in the next wave of the QLFS panel, which was just three months later. Some of this relates to measurement error, but it still seems that the sector is incredibly fluid. One out of every three people employed in the informal sector were employed in the formal sector by the next quarter, while one out of four people employed in the informal sector in the next quarter were employed in the formal sector in the preceding quarter. Rates of entry and exit into and out of unemployment appear substantially lower in comparison. The implication of these findings is that the informal sector is probably more likely to absorb people who leave formal-sector employment (24,78%), either voluntarily or involuntarily, rather than to reduce the existing pool of the unemployed (7,29%).

Considering that a large proportion of the informally employed are own-account workers, the relatively weak transition of people from unemployment to informal-sector employment is likely due to certain intractable barriers to starting a business, such as entrepreneurial initiative, access to capital and having some degree of business acumen. Therefore, opportunities for the transition of more unemployed individuals to employment in the informal-sector employment may reside more in the ex-

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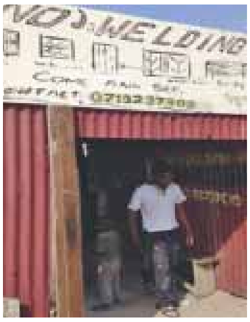
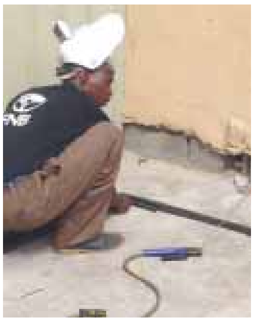




pansion of existing informal businesses, which could then employ more people. In this respect, the two barriers to growth most frequently cited by owners of informal businesses are access to better locations (41,4%) and stifling government regulations (40,4%), both of which have implications for how the City of Cape Town can best maximise the sector's potential to help reduce unemployment and poverty.

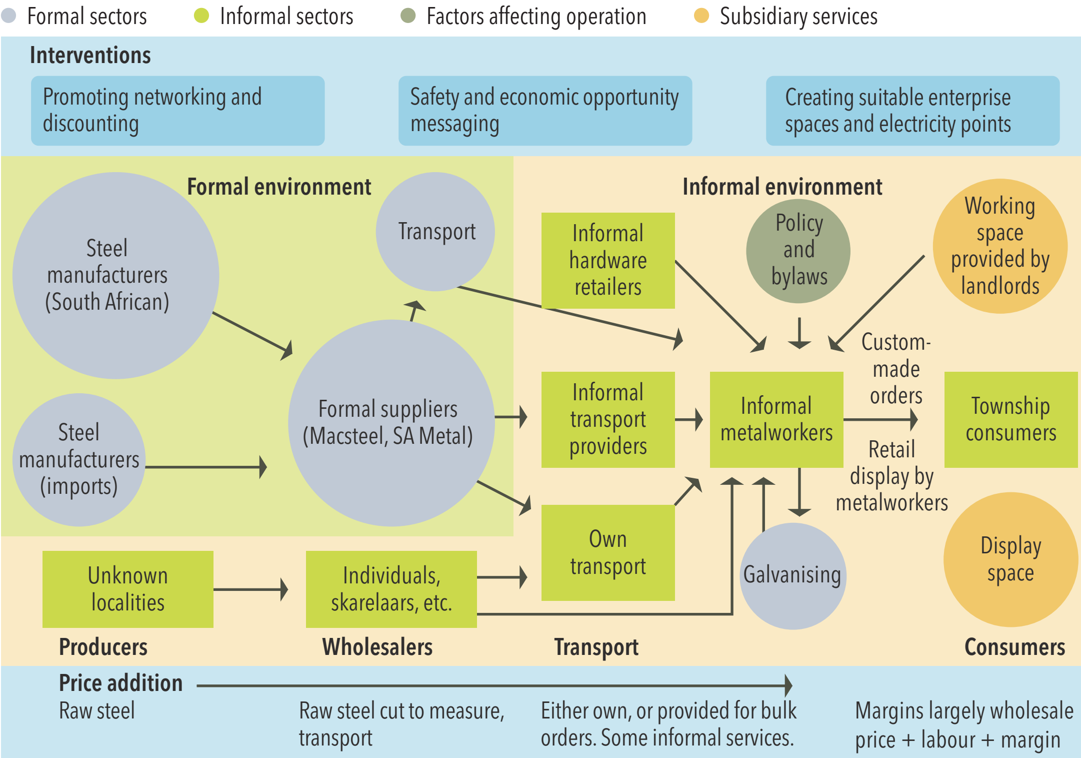
PROMINENT INFORMAL VALUE CHAINS IN CAPE TOWN

While informal trade is the predominant type of informal economic activity, it is by no means the only or the most productive. Specialised informal production of goods, whether in public areas (such as those identified in the section on spatial trends) or residential areas, offers the most potential for growth and value addition. One such informal economic activity is metal product micro-manufacturing and sales. A value chain analysis, as depicted below, helps illustrate the stages of value addition associated with this type of activity and, importantly, its linkages with formal businesses.

Metal product micro-manufacturing businesses specialise in the manufacture (welding) of burglar bars, security gates and car body repairs. The sector is relatively skills-intensive and relies on supplies of raw material inputs in the form of steel, locks, hinges, welding rods and equipment. The majority of businesses in this sector in Cape Town yield a profit of approximately R5 000 per month (significantly more than the average wages in the informal sector) off a trade revenue of R8 500 to R13 500 per month. These characteristics describe businesses that operate beyond survivalist levels and that have the potential to create employment and transfer skills. However, significant challenges for these businesses relate to a lack of space to operate, the health and safety of metal workers and the general public, and enterprises' lack of access to credit. In the township context, the construction of metalwork items also brings about environmental, town planning and land use incompatibilities (i.e. excessive noise) with residential living. Informal metal workers, according to the earlier distinction, would be regarded as specialised traders who could benefit from specific strategies, such as clustering in light industrial parks on the edge of townships, for example.

The majority of metal product micro-manufacturing businesses in Cape Town yield a profit of approximately R5 000 per month (significantly more than the average wages in the informal sector) off a trade revenue of R8 500 to R13 500 per month. These characteristics describe businesses that operate beyond survivalist levels and that have the potential to create employment and transfer skills.

Figure 37: Value chain for informal metal manufacturing



Source: City of Cape Town, 2015b.