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Malawi Congress of Trade Unions (MCTU)



Research Report: Drivers of informality in Malawi

"A case of SMEs and domestic workers"

Report 2019

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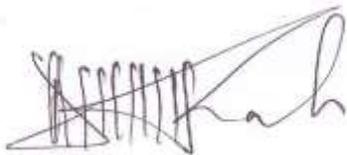
Executive Secretary

In Malawi like many other African countries the Institutional and legal barriers make it costly for small-scale informal enterprises to formalize. Business licensing and registration procedures often fail to cater to the realities of informal self-employment. These processes may be overly complex and prohibitively expensive, leaving own-account workers, domestic workers and other small-scale enterprise workers with no option but to work informally.

Moreover, there is no incentive to formalize when public support for informal workers, through policy initiatives, service provision, and infrastructure investment, is underdeveloped or non-existent. Again, when the costs of formalization exceed the benefits, workers in the informal economy, whose earnings already often fall below a basic poverty threshold may find it impossible to operate formally.

In addition, domestic workers in Malawi are the lowest paid, mainly because employers take into consideration the food and accommodation when calculating their salaries. In Malawi, most domestic workers work in the house which is considered as a private entity hence difficult for the Ministry of labour to undertake labour inspections and for trade unions to organize and recruit them. This situation has indeed exposed domestic workers to vulnerable and precarious working environment.

Informality should be discouraged at all cost, since its implications go beyond the informal worker. It is therefore very critical for the government and stakeholders to provide alternatives to informality, for instance creating more sustainable and decent economic opportunities that should attract those in the informal or planning to enter the informal economy. In addition, there is also a great need to put in place various support systems that will help informal workers and entrepreneurs to transition to the formal economy. More important is the need to develop a well-coordinated approach, where all key stakeholders play a role towards formalization.



Denis Chalera Kalekeni
MCTU Secretary General

Chapter one

1. Introduction

This study explored drivers of informality: a case study of domestic workers and Micro, Small and Medium Entrepreneurs (MSMEs) in Malawi. In the recent years, informal employment and economic activities have become a fashion for the majority of Malawians such that the working and middle class are leaving formal jobs for various informal economic activities (Heints and Valodia, 2008). In addition, the unemployed labour force both skilled and unskilled is also entering the informal economy as entrepreneurs or ordinary workers (ILO, 2014).

There is extensive empirical evidence which broadly justify reasons why entrepreneurs and workers enter the informal economy, however the rate at which MSMEs and domestic workers are finding their way into the informal economy has become a threat towards achieving inclusive development in Malawi (Kachali, 2018). The situation calls for urgent action from the government and other key players which includes trade unions, employers and other concerned parties.

Informality is indeed a developmental issue that demands for a collective effort from all stakeholders (Ministry of Labour, 2011). It is undisputable that informality cannot be addressed in a day but rather gradually. Studies confirm that particular groups of workers or entrepreneurs in the informal economy demands specific interventions for successful transitioning to the formal economy.

The next section will discuss the background information and main objectives of the study. Chapter two will look at literature review followed by research methodology in chapter three. Chapter four will discuss research findings followed by recommendations and conclusion of the study.

1.1. Background

In the recent years, there has been an increase in the number of workers and economic units entering the informal economy either by choice or force (Canelas, 2015). The recent data is not clear on what percentage of the labour force is in the informal economy as of 2019, but according to the National labour Force survey of 2013, it was estimated that over 89% of workers and economic units are operating in the informal economy in Malawi (NSO,2014).

Informality comes with decent work deficits which expose workers and economic units to economic poverty, inequalities in terms of access to formal business tenders, social justice, financial opportunities and financial services among others. Informal workers voices are mostly not recognized by the government and other stakeholders especially when they are not organized (Kachali, 2017). However, the situation is different for their counter parts in the formal economy where work or business deficits are minimal due to the availability of negotiation and labour or business forums where issues of interest are

discussed for instance the Tripartite Labour Advisory Council (TLAC) and collective Bargaining Agreements (CBAs) among others.

A bracket approach has been used to describe the causes of informality such as the implementation of the Structural Adjustment Programs (SAP) and policies between 1981 and 1994. For instance, the privatization of government enterprises led to massive retrenchments, in addition the cutting of public expenditure also contributed to high school/university drop outs. The effects of implementing SAP in Malawi has been disastrous and the immediate ones include increased poverty levels and booming of the informal economy.

Furthermore, there is absence of empirical data in regards to the explicit factors that drive MSMEs and domestic workers into informality. This has thwarted trade unions and other interested parties in formulating effective interventions that would not only address decent work deficits but also prevent more workers and economic units from entering the informal economy. It is against this background that this study aimed to identify factors that push domestic workers and MSMEs into the informal economy for proper planning.

1.2. Objectives

1.2.1. Main objective

- To identify drivers of informality among MSMEs and domestic workers in Malawi

1.2.2. Other objectives

- To identify key trade union roles towards decent work promotion
- To identify key areas for trade unions' capacity building
- To formulate strategies for promoting decent employment

Chapter two

2. Literature Review

2.1. Introduction

This chapter will discuss the views of other scholars and writers on the definition and drivers of informality. It will look at a global perspective and then zero in at a regional level especially Africa. The discussion will also look at informality in the Malawian context.

2.2. Understanding Micro, Small and Medium Enterprises and Domestic workers

2.2.1. Micro, Small and Medium Enterprises (MSMEs)

Zidana (2015), states that there is much evidence on the central role played by the micro, small and medium enterprises (MSMEs) and the contribution they make to the socio-economic development of economies, and this is well documented in literature. Study findings by Peterhof, Romeo and Calvey (2014) showed that small and medium enterprises account for 90% of all businesses globally.

In addition, MSMEs were reported to generate 60% of employment worldwide and provide jobs to roughly 80% of workforce in the developed world. Kyaw (2008) as seen in Zidana (2015) rightly summarized the key characteristics of SMEs including being naturally more labour intensive, their focus on small markets, low capital requirements and the associated ease to start. In addition, most SMEs are characterized by non-existent separation of ownership and management. It is the latter characteristic that has led to conclusions that small scale businesses tend to be innovative and responsive to market needs because their relatively small sizes position them very close to the customer which results in the development of strong business-customer intimacy.

With a narrow customer base, the customer relationship is cherished more and nurtured unlike with larger enterprises whose market relationships are often impersonal. Micro, Small and Medium and Enterprises are indeed vital in achieving decent and productive employment. However, the definition of MSMEs is very debatable. For instance, Milagrosa and Reeg (2016) defines MSMEs as formal and informal enterprises with up to 19 regular employees while on the other hand the Finscope MSMEs Survey of 2012 and 2019 defines MSMEs in terms of employees and annual turnover as shown in the table below:

Table 1:

Category	Employees	Turnover	Value of Assets (excl' land & buildings)
Micro-enterprise	1 to 4	Up to K5,000,000	K1,000,000
Small enterprise	5 to 20	K5,000,001 -K50,000,000	K20,000,000
Medium enterprise	21 to 99	K50,000,001 - K500,000,000	K250,000,000

The definitions above exclude millions of SMEs in Malawi especially those in the informal economy as majority operate below assets of value less than MK 1,000,000. Hence it is important that a broader definition be developed to fit the Malawian context and in this study the terms MSMEs and SMEs will be used interchangeably.

2.2.2. Domestic Workers

The ILO Convention 189 defines Domestic Work as work performed in or for a household or households. Domestic work is therefore defined according to the workplace, which is the private household. Broadly speaking domestic workers provide personal and household care. Occupations and tasks considered to be domestic work vary across countries but, mostly they may cook, clean, take care of children, the elderly and the disabled, attend to the garden or pets, or drive the family car. They may work part-time, full-time or on hourly basis, and may live in the home of the employer or not. The ILO further estimates that there are at least 67 million domestic workers over the age of 15 and 80% of which are women. In Malawi statistics are not clear regarding the number of domestic workers since majority are informally employed and work and stay at the employer's house hence difficult to tell if one is a worker or a relative.

2.3. Understanding Informality

According to Cangul, Jonelis, and Medina, (2016) the characterization of the informal economy has been debated in both policy and academic circles. There is no standard definition of the informal economy in the literature, and terms such as *shadow economy*, *black economy* and *unreported economy* have been used to define it. Feige (2005) as seen in Cangul, *et al* (2016), states that the phrase informal economy has been used frequently, and inconsistently; he argues that the informal economy comprises economic activities that circumvent costs and are excluded from the benefits and rights incorporated in laws and administrative rules covering property relationships, commercial licensing, labor contracts, torts, financial credit, and social systems.

Workers in informal employment earn less, have more volatile incomes, lack access to basic public services and protections, and face higher risks of poverty compared to workers in formal employment (ILO, 2009). Therefore, the issue of informal and non-standard employment deserves special attention. The concept of informal employment is meant to capture employment relationships that are not governed by formal economic regulations and/or basic legal and social protections. Often, the term "informal employment" is applied to the labour markets of developing countries. In higher-income economies, it is more common to speak of "non-standard" or "a-typical" employment. These two concepts are not the same. Informal employment typically refers to employment that is not subject to legal or economic regulations. That is, the emphasis is on the regulatory status of the enterprise or the job. "Non-standard employment" refers to variations in the employment relationship relative to a dominant or traditional form (ILO, 2014). The concept of informality has actually been a topic of interest in various

development forums. However, for the sake of consistency this study will stick to the definition by the ILO.

According to Recommendation 204 of the ILO, the informal economy refers to all economic activities by workers and economic units that are -in law or practice-not covered or insufficiently covered by formal arrangements. The Enterprise Definition (ED) of employment in the informal sector refers to all jobs in the informal sector enterprise and while informal employment according to a Job Based Definition (JBD) refer to all informal jobs whether carried out in formal sector enterprises, informal sector enterprises or households, (ACTRAV Bureau of Workers activities,2015).

2.4. Informality levels in the world and Africa

The ILO report titled "*Women and Men in the informal economy*" states that approximately two billion of the world's employed population aged 15 and over work informally, representing 61.2 per cent of global employment (ILO, 2018). The proportion of informal employment varies in different regions. Among the five main regions, the vast majority of employment in Africa (85.8 per cent) is informal. Asia and the Pacific (68.2 per cent) and the Arab States (68.6 per cent) have almost the same level of informality. In the Americas (40.0 percent) and Europe and Central Asia (25.1 per cent), less than half of employment is informal.

In most countries the socio-economic development is positively correlated to formality. Emerging and developing countries have higher shares of informal employment than developed countries. Emerging and developing countries represent 82 per cent of world employment, but 93 per cent of the world's informal employment is in these countries (Andrew, Leandro, and Mehmet, 2017).

Andrew, et al, (2017), add that more than two thirds of the employed population in emerging and developing countries are in the informal employment (69.6 per cent), while less than one-fifth of the employed population (18.3 per cent) are in developed countries. It is important to note that informality exists in both the formal and informal economy. For instance, the 61.2 per cent of global employment that is informal is comprised of 51.9 per cent in the informal sector, 6.7 per cent in the formal sector and 2.5 per cent in households. In all regions employment in the informal sector is the largest of the three components of informal employment. Informal employment in the formal sector is a somewhat large proportion of informal employment in two regions: America and Europe and Central Asia, where it represents 7.9 per cent and 5.3 per cent of total employment respectively. The share of informal employment in the formal sector concerns primarily employees and to some extent contributing family workers. The 39.7 per cent of all employees in informal employment is comprised of 10.8 per cent who are informally employed in the formal sector and 2.1 per cent who are employed as domestic workers in households. The share of employees in informal employment in the formal sector represents 27.4 per cent of total informal employment among employees

worldwide and up to 42 per cent in Latin America and the Caribbean and more than half in developed countries from Europe and Central Asia. Among the five regions, the level of informal employment in households in Africa is the highest at 4.3 per cent and the global average rate is 2.5 per cent (Andrew, et al, 2017). The share of informal employment normally decreases when agriculture is excluded but the distribution of informal employment in different sectors does not necessarily follow the same pattern. In most regions, informal employment in the formal sector increases with the exclusion of agriculture and exceeds the global average (8.0 per cent), for instance from 5.7 per cent to 9.5 per cent in Africa, from 7.5 per cent to 8.7 per cent in the Arab States and from 6.9 per cent to 8.8 per cent Asia and the Pacific.

2.5. The causes of informality

The causes of informality in Africa are complex but broadly related to some key factors prominent in African economies of the last few decades (Canelas, 2015) such as the lack of economic development and the deep-seating structural adjustment that has characterized economic policy since the 1970s. Most of the African continent has experienced extremely low and patchy rates of economic growth. Employment creation, in this environment, has been very poor. At the same time, labour force participation rates, particularly among women and youths, are often high, and for some countries large numbers of new entrants, again particularly women (see Casale and Posel 2004), have entered the labour market. Many of these workers, unable to find employment in the formal sector, have had to survive on low incomes generated in the informal economy.

A number of studies in Africa have highlighted the rapid increase in Levels of urbanization, which has contributed to a growth in the urban labour force. Many of these workers living in urban slum areas around the major cities earn their livelihoods in the informal economy. In addition, following structural adjustment policies implemented in most African countries, and these countries' integration into the international trading system, segments of the indigenous manufacturing economy in Africa have been undermined by cheaper imports. This is probably best illustrated by the decline in clothing manufacturing in many African cities and by the rise in informal manufacturing activity. Rogerson and McCormick (2004) provide a good overview of the clothing industry in Africa, and the rise of informal manufacturing activity.

The deficit reduction and privatization components of structural adjustment programmes reduced public sector employment in government wage employment and in public enterprises. Public employment is an important source of formal employment in most African countries. Private sector employment growth has not compensated for this loss of formal jobs, leading to higher rates of informalization. In Africa most women are disadvantaged in the education system and discriminated against in the formal

economy, hence the informal economy offers the only opportunity for income generation (Heints and Valodia, 2008).

Indeed, drivers of informality are complex for instance, in Malawi like many other African countries the Institutional and legal barriers make it costly for small-scale informal enterprises to formalize. Business licensing and registration procedures often fail to cater to the realities of informal self-employment. These processes may be overly complex and prohibitively expensive, leaving own-account workers and other small-scale enterprise workers with no option but to work informally. Moreover, there is no incentive to formalize when public support for informal workers, through policy initiatives, service provision, and infrastructure investment, is underdeveloped or non-existent. Again, when the costs of formalization exceed the benefits, workers in informal activities, whose earnings already often fall below a basic poverty threshold may find it impossible to operate formally.

Lastly, in a number of African countries, much of the population earn their incomes in an environment characterized by high levels of violence. In some economies war has been endemic, leaving behind frayed social and economic relationships, ruined infrastructure, and fundamentally disrupted possibilities for remunerative employment. This has had the impact of not only undermining economic activity but has also displaced large numbers of Africans who, as political refugees, have had to earn their livelihoods in neighboring countries but mostly in the informal economy.

2.6. Linkage between informality and poverty

The importance of the informal economy is now widely acknowledged, its linkages with poverty are still controversial. As far as a connection between poverty and informality is concerned, there are two schools of thought which fall under the pessimistic and optimistic groups. In the pessimistic point of view, the informal sector consists of marginal and subsistence activities, where the productivity and earnings of its participants remain low. Informal workers enjoy little social protection, and working conditions are very poor (ESCAP, 2006) and this is also evident in most African countries including Malawi. Therefore, the informal sector perpetuates poverty and the effect of informality on poverty reduction is negative.

In addition, Timofeyev (2013) uses the latest available data from the Russian Federal State Statistics Service to calculate labor income scales for the poor in the informal sector, and compares them to average wages in the formal sector and with the official poverty line of Russia. The study concludes that while the informal sector is a factor of social stability in a post-socialist transition economy, it cannot, however, alleviate poverty.

The second view is that not everyone working in the informal sector is poor, and there is a positive link between informality and poverty alleviation. A number of empirical studies support this optimistic sentiment. Admittedly, the vast majority of informal participants have low incomes and live below or close to the poverty line (ESCAP, 2006). However, without the informal sector, the intensity of poverty would be much higher. Cartaya

(1991), as cited in Orlando (2001), emphasizes that in Venezuela, a significant portion of household income comes from the informal sector, for both poor and non-poor households.

There is an important relationship between poverty intensity and informality, given that the families in extreme poverty earn the greatest part of their income from the informal sector. Additionally, Orlando (2001) shows that the increase in the rate of informal earnings is lower than the increase in the rate of employment. This means that the incidence of poverty is higher in the informal sector than in the formal sector. Hence, he suggests that a strategy to reduce poverty should be to increase productivity and wage levels in the informal sector through improving education, working experience, and capital access for informal employees. Agarwal & Dhakal (2010) show that in developing countries, the main reason for joining the informal sector is to safeguard poor and marginalized from poverty and unemployment.

Based on Nepal's experiences, Agarwal and Dhakal (2010) also suggest that the informal sector is a good source of livelihood for poor and marginalized groups. They prove that earnings from the informal sector have had a strong impact on the households' livelihood. Surprisingly, without the earnings from the informal sector, more than 94 per cent of households in Chitwan district of Nepal were drowned in poverty, but due to the income generated from the informal sector activities there has been a remarkable shift and only 12.9 per cent of households remain in poverty, while 46 per cent of the households have been able to join the middle income and high income classes.

Chapter three

3. Methodology

3.1. Introduction

The purpose of this chapter is to explain the research methodology that was used to collect data. The discussion focuses on research approach, data collection methods and the sampling methods. Further, the chapter describes the data analysis process.

3.2. Qualitative method

A qualitative method was the appropriate method to be applied and according to Merriam (2009, p. 13) qualitative research is "an umbrella term covering an array of interpretive techniques which seek to describe, decode, translate, and otherwise come to terms with meaning, not the frequency, of certain more or less naturally occurring phenomena in the social world". This study was interested in understanding the challenges, and factors that influence or push SMEs and domestic workers into the informal economy. To collect reliable data respondents were visited in their respective workplaces, however for domestic workers prior arrangements with their employers were made.

3.3. Data Collection

In this study, semi-structured interviews were used to collect data. One to one interviews and focus group discussion were selected mainly because they allow the researcher to get a deep understanding of the subject under study.



Focus group discussion in session

3.4. Sampling

Purposeful sampling was applied in this study. Purposeful sampling also known as non-probability or judgmental sampling is a technique that selects units such as individuals

based on specific purposes associated with answering a research question in a study (Teddlie and Yu, 2007). According to Henning (2004), purposeful sampling is a selection of population that represents data of research in which correspondents are able to give more information on the issues being studied.

A non-probability sampling was used to select respondents and the researcher chose snowball sampling, also known as chain referral sampling. In this case respondents (SMEs and domestic workers) were identified by the general secretaries of MUFIS and CIAWU and later the identified respondents ably referred the researcher to the next person to be interviewed.

3.5. Data analysis

Thematic data analysis technique was used to analyze the data. The researcher identified themes and patterns in the data collected (Wagner et al., 2012).

3.6. Credibility and Trust-Worthy of the study

The study used different data collection tools which allowed the researcher to validate the collected data. Secondly three research assistants were involved which allowed the collection of reliable and trustworthy data, since one set of data was compared to another.

3.7. Limitations of the research

Data collection was done in 6 weeks and in 9 districts across Malawi. 6 weeks was not enough for the researchers to establish good rapport with participants for reliable and credible data. The study followed the constructivism paradigm and the sample size used was not representative hence the findings are limited to the study area.

3.8. Ethical Consideration

The study adhered to all ethical consideration, for instance the researcher clearly explained the purpose of the study and assured no harm to its participants. The study also obtained informed consent from its participants before interviews. Privacy and confidentiality was also assured to its participants and all participants were told that they have the right to withdraw from the study at any stage of the interview process.

CHAPTER FOUR

4. RESEARCH FINDINGS

4.1. Introduction

This chapter will provide an analysis of the research findings. As pointed out in the problem statement, majority of the labour force in Malawi is entering the informal economy and this has become a developmental threat to the government, and the general communities.

Literature confirms the statement and according to Kachali (2018), informality reduce government revenue, negatively affect business competition and growth, and leads to decent work deficits and various social ills in the world of work and communities. It is the intention of this study to identify and discuss the root causes of informality among MSMEs and Domestic workers in Malawi. The ultimate goal is to allow trade unions to formulate relevant strategies which would contribute towards the formalization of the informal economy and at the same time help in the fight against poverty.

4.2. Respondents Profile

Table 1:

Sex/gender	Age (in years)				Unspecified data in terms of age and occupation		
	18 and<35		35≥		Male	Female	
	MSME	Dom	MSME	Dom			
					24	20	42
M	95	20					115
M			71	8			79
F	67	26					93
F			102	35			137
Grand total							466

Key: MSME= Medium Small and Medium Entrepreneurs, Dom= Domestic worker, ≥= greater than or equal to and < = less than All

The study conducted 8 focus Group Discussions (FDGs) per district and each FDG was composed of 6 to 12 participants depending on availability of participants. In addition, a total of 34, one to one interviews were also conducted with a minimum of 3 interviews per district. A total of 466 respondents were interviewed in this study of which 250 were females, and 93 females were between the age group of 18 and 34 years and 137 were 35years and above, while 20 females did not indicate their age group and occupation. 169 were female SMEs and 61 were female domestic workers.

On the other hand, 218 respondents were males, out of which 115 were in the age group of 18 to 34 years and 79 males were 35 years and above while 24 males did not disclose their age group. In the age group of 18 to 34 years there were 95 SMEs and 20 domestic workers, while 71 SMEs and 8 domestic workers were 35 years and above. On a separate note the study found that over 90% of these respondents did not belong to a trade union and almost 50% said they have never heard of an organisation called trade union and did not know their functions. Majority of the respondents confirmed to have low and irregular income and further said they struggle to meet all the basic necessities in life.

4.3. The relationship between informality and poverty

According to the Nation Labour Force survey of 2013 and the Labour market Profile of 2018, confirms that the majority of informal workers are found in rural areas especially in the agricultural and the construction sector. Most SMEs in Malawi operate as retailers and a large number of these are also located in residential areas. On the other hand, it was noted that most domestic workers are informally employed in urban or semi-urban areas with few in rural areas. In addition to the above findings it was noted that low and irregular income was common in both SMEs and domestic workers.

Indeed, there is a two-way relationship between informality and poverty and there is empirical evidence, which confirm that informality somehow leads to poverty and vice versa. For instance, 80 percent of the SMEs that were interviewed in this study indicated that in a day they make an average income of between Mk750 to Mk 4000 (1 USDs to 5 USDs). However, this amount is inclusive of all other expenditure that they incur on a daily basis including market fees, transport to and from work/market, utility costs like lunch, drinking water and toilet services while at the market place. Similarly, close to 50 percent of the domestic workers who were interviewed indicated that they receive below the national Minimum wage of MK 25,000 (33.3USDs). The above assertion agrees to the fact that income levels for the majority of workers in the informal economy is very low and unstable which expose them to economic poverty.

It was also clear from the fields that around 99% of the respondents did not put their business on insurance cover and similarly they were not subscribed to any type of formal social protection systems. However, it was noted that majority of informal workers take part in various informal financial services like village savings and Loans groups (VSLGs) which provide various financial services to them ranging from social protection to loans with flexible repayment conditions.

It is undisputable that the working conditions in the informal economy are precarious and indeed expose most workers to economic poverty and various decent work deficits. According to Centre for Social Concern (CFSC) Basic Needs Basket (BNB) as of June 2019, for a family of 6 to survive for a month they need a minimum of MK196, 450.00. Comparing the Nation Minimum wage and the BNB by the CFSC of June 2019, it is very clear that majority of workers in Malawi struggle to make ends meet on a daily basis.

However, the above assertion does not mean that informality cause poverty but rather it is among the key factors that leads to poverty. On the other hand, within informality we have good practices, where workers' rights are respected and workers are sometimes paid above the minimum wage. In addition, experience has also shown that economic activities in the informal economy allow households to meet utility and, other daily expenses. Majority of the respondents testified that informal economic activities help them survive on a daily basis but emphasised that it is not easy, since the incomes are unpredictable and low.

According to one respondent in her late 60s' who has been in a soap making and cloths dyeing business since 1994 narrated her story as follows;

“I have educated all my four children up to tertiary level from this business and they are all working. It has not been easy for me considering that my husband lost his job in the early 1990s. My income has never been enough as the little money from the business pays off the household's bills, fees, and other costs. I have the capacity to grow and create more jobs but the government systems are not favourable to Small scale entrepreneurs for instance to be certified by the Malawi Bureau of Standards is not easy and it may take years, in addition it is expensive to register a business in Malawi”.

Despite the struggle associated with the informal economy, it is clear that most households survive using informal economic activities. It was also observed during data collection that majority of informal workers lives a minimalistic type of life not by choice but rather due to their financial circumstance. A case above demonstrates that it is tough to survive in the informal economy but at the same time it proves that households sometimes are able to meet primary expenses.

The above discussion agrees to the fact that informality is among the factors that might push households or workers into poverty, and on the other hand it demonstrates that families are able to meet their day to day expenses with the income from the informal economic activities.

Despite the positives associated with informality, it is important that government, trade unions, employers and other stakeholders put measures in place to allow the formalization process to take place and also to discourage workers and economic units from entering the informal economy. It is also very important that drivers of informality are well known by all the stakeholders for relevant strategies and interventions.

4.4. Factors that push SMEs and Domestic workers into informality

Drivers of informality vary depending on the employment sector and more on the political and socio-economic context of the country. Numerous studies confirm to the above statement and recognize the existence of both broad and specific drivers of informality at different levels (ILO, 2009). Some factors push all sorts of occupations into informality, while others target specific occupations. In this section the discussion will zero in on broad factors that mainly push SMEs and domestic workers into informality and below are some of the push factors;

4.4.1. Failure to meet basic needs costs

Over 90 % of the respondents identified poverty as the main reason why they are found in the informal economy. Respondents defined poverty as a status of lacking sustainable source of income to allow a person or households to meet essential costs like food, housing, health and other essential services among others. For instance, according to a lady in her late 50s said that;

“I decided to venture into the vegetable business because I could not afford to meet the costs for basic needs for my family. I have 5 children and 3 grandchildren that I look after. I am uneducated, I cannot write and read and no employer want to employ me, hence I decided to start doing piece work and on average I could make Mk 1,500 to Mk 3000 (2 to 3 USDs) per day from which I could use to buy basic needs and at the same time save for my business capital and it took me close to 6 months to raise a capital of Mk7, 000 for my business. I struggle to make ends meet because my husband passed on after I gave birth to my last born who is 5 years now. I struggle in this business and am challenged in terms of business growth because I live on hand to mouth”.

The case above demonstrates the need to afford and provide basic needs to family dependants and it is among the key factors that some people enter the informal economy. It also shows that the informal sector is the only reliable option for those excluded by the formal employment. Studies have shown that SMEs and workers in the informal economy have very low levels of income which further expose them to poverty (Finscope, 2012 and 2019)

4.4.2. Lack of appropriate qualifications and demand driven skills

Over 70% of the respondents were unable to write their names on the attendance list and 50% of them indicated that they dropped out before completing primary school. Indeed, there is a cordial relationship between illiteracy and informality in Malawi and specifically in the rural areas (Finscope Survey 2012 and 2019). Most unskilled workers in the informal economy are employed as casual workers or run their own small scale businesses.

Experience indicate that the formal economy everywhere, prefer to employ skilled labour as it is seen efficient and effective in production. The formal employment system also automatically leaves out those without formal skills. Indeed, employers today prefer labour that has formal skills, in addition to the ability to write and speak English mainly because the world is becoming a community due to the forces of globalization.

Mostly the labour force that is excluded by the formal system enter the informal economy as workers or entrepreneurs, and majority of these workers do not have appropriate skills for employment or entrepreneurship this is also confirmed by Kachali, (2017 and 2018) and Heints and Valodia (2008). Most entrepreneurs in rural areas do not have specific skills or knowledge relevant for business management like record keeping, budgeting, customer care, marketing among many other business skills, as a result most informal SMEs fail to grow.

However, a study conducted by Kachali in 2017 on *"skills gap analysis in the construction industry"* found that those without formal qualifications were able to perform better than those who have undergone the TEVET formal training system. Despite many cases of outstanding performance by informal workers they still work under vulnerable and precarious working conditions. Lack of appropriate skills and recognition of prior learning push such workers into the informal economy.

4.4.3. Low formal employment opportunities

According to the Malawi Labour Market Profile of 2018, 27% of the employed labour in Malawi was underemployed and unemployment rate was at 5.9%. The unemployment level in Malawi seems to be very low mainly because a strict ILO definition of unemployment was used to assess unemployment. However, the unemployment level in Malawi is getting worse especially when the ILO broad definition is applied. The youth and women occupy the largest share of the unemployed population in Malawi and they are the face of informality. Unemployment is among the key development threats in Malawi, and government together with development partners have prioritized employment creation, for instance MDGS III and SDGs states that in order to address unemployment and poverty there is a need to promote skills development and sustainable economic growth.

It is evident that those excluded from the formal economy found their way into the informal economy. Indeed, unemployment has the ability to drive away active labour force to other economically active neighbouring countries like South Africa and Botswana.

Most of the people interviewed in this study indicated that informality has always been their immediate alternative to the scarcity of formal employment. Indeed, lack of adequate formal employment opportunities has forced the unemployed labour force to

enter the informal economy and according to the Malawi Labour Market Profile of 2017, stated that around 130,000 young people enter the labour market every year, but only 30,000 formal jobs are created. Approximately 100,000 workers found employment or start economic activities in the informal economy. The informal economy has always been the immediate option for the jobless because there are no pre-conditions for one to operate or work in it.

4.4.4. Lack of appropriate information on business registrations and formalisation

Majority of the SMES and domestic workers interviewed in this study showed that they have low levels of knowledge and information regarding labour laws, business registration and the formalization process among others. For instance, 80% of the respondents were unable to mention any of the labour laws, or any requirements for business registration, however one old lady from Dowa mentioned that a business is supposed to be registered to compete in the formal market. But since she started her business she has been unable to register, mainly because of lacking appropriate guidance on the steps towards business registration.

According to another woman in her early 50s from Mzuzu who has been running a registered restaurant since 1997. She indicated that in the year 2000 she won a catering contract with one of the parastatals' organisation. However the Malawi Revenue Authority demands that all government entities should only outsource services from registered business which comply and remit taxes. The woman started paying tax but she was shocked to note that her tax arrears were backdated to the year 2000. Up-to-date she is expected to pay not less than 3.5 million Malawi kwacha and a quick analysis of her business show that she makes around Mk 200,000 as net sells per month.

This is a clear example of how lack of appropriate information cost SMEs when it comes to formalizing their businesses. Such circumstances prevent many SMEs to formalize as they believe the cost is higher and a threat to their survival on the market.

4.4.5. Government Bureaucratic systems

Majority of people interviewed in this study expressed disappointment in the way government institutions handle their day to day businesses. Most government processes take very long time to be concluded due to the bureaucracy within their systems. For instance, to register and operate a food or soap processing business one has to meet various requirements as set by the various government entities which may include but not limited to the following:

- Apply for a Certificate of Incorporation at the Registrar General of the Ministry of Justice
- Register for income tax at the Malawi Revenue Authority
- Apply for a license from the City Assembly to operate in the chosen area
- Apply for a registration of the workplace

- Receive inspection of the company/business premises by the Occupation Safety, Health and Welfare department
- Register for PAYE and fringe benefit tax at the Malawi revenue Authority

In addition depending on the sector, the business will also need to be registered with additional government entities like; Department of Environment Affairs for Environment and Social Impact assessment certificate, and for a hospitality business entity must register with the Tourism and Hotels Board to get a Tourism Development Certificate among others (for more information see www.registrargeneral.gov.mw and www.theguides.org/public-docs).

8 in every 10 respondent's stated that Issues of corruption, lack of transparency and accountability are common when dealing with government processes. Hence most informal workers see formalization as an expensive process and not developmental since taxes and other government fees associated with formalization are used for personal benefits. It was also noted that some of the steps/requirements towards formalization take time hence creating room for bribery or corruption activities. This has created lack of public trust in the public institutions. In addition, the absence of a one stop centres in most rural areas make it more difficult and expensive for rural workers and SMEs to formalize since they are required to travel long distances to cities to complete process.

4.4.6. Globalization

Globalization has made the formal market uncondusive for the majority of the local SMEs in Malawi. The coming in of cheap products from other countries has pushed local SMEs into the informal economy. It is also sad that the Chinese, Somalians, Indians, and Burundians who are supposed to operate at a wholesale level, they sell their items at retail price in communities and rural areas hence making the market uncondusive for local traders. 90% of the SMEs interviewed in this study confirmed that they compete with foreigners even at retail level this has made local SMEs less competitive and more vulnerable to closure and this was seen in Mchinji, Dedza, Karonga and Balaka among other districts.

On a separate note, due to the stiff competition, 90% of the SMEs interviewed had no permanent physical structure or address as most were very mobile in search for customers. This is the common strategy among SMEs in Malawi to survive on the market but also a threat to the formalization process. It was also noted that most customers for SMEs are located in deep rural areas and depend on the agricultural season. Indeed, the rural economy in Malawi is small and unpredictable, this contextual status of the rural areas has indeed forced majority of the SMEs to operate in the informal economy considering that formalizing would be more costly and demanding them to comply with the formalization conditions. Informality does not expect SMEs to obey labour laws or pay government fees on a regular basis except for those operating in public markets where they are required to pay a daily market fee.

In summary majority of the economic units and workers in rural areas enter the informal economy, mainly because of the limited formal employment opportunities, unlike those in urban areas where it's by choice. For instance, workers with formal jobs are preferring to operate economic activities in the informal economy due to the flexibility and the profitability of the economy. Actually, informality is on the rise in urban areas because of its attractiveness and its convenience in terms of point of sales i.e. along roads and close to residential areas in addition to price flexibility among others.

Chapter 5

5. Recommendations

This chapter will recommend interventions for trade unions and stakeholders to minimize the informalization of the formal economy and further prevent economic units and workers from entering the informal economy. It will end the chapter by a brief conclusion reflecting on the key points.

5.1. Recommendation

The next section will present various strategies for trade unions and other stakeholders to consider towards assisting informal workers and SMEs to transition to the formal economy.

5.1.1. Promoting partnership and capacity building

Tackling informality is a gradual process that demand stakeholder's commitment and more important partnership. As discussed earlier informality exist in almost all sectors of the economy, hence it is important for stakeholders within a particular sector to collaborate towards addressing the key causes of informality. In this case in order to effectively address the push factors of informality for SMEs and domestic workers in Malawi, this study recommends the establishment of a network which should include the following stakeholders,

- Trade Unions
- Employers
- Ministry of Trade and Industry
- Small and Medium Enterprise Development Institution
- District and City Assembly
- Ministry of labour and Vocational Training
- The National Association of Business Women (NABW)
- Malawi Revenue Authority (MRA)
- Malawi Investment and Trade Centre (MITC)
- Ministry of Justice- Register general

The proposed network main role will be to map out a strategy that should help SMEs and domestic workers to transition from the informal to the formal economy. Each institution above has a specific role that it can play towards addressing specific drivers of informality. However, it is also important to identify knowledge gap within each institution on the concerned subject. This will allow a productive engagement among the stakeholders.

Formalization is a challenging process mainly because it demands commitment from the various stakeholders. For instance, the process may require employers and entrepreneurs to remit taxes like Pay as you earn (PAYE), income tax, in addition to pension contributions. It also demands compliance with Occupational Safety and Healthy (OSH)

measures for the safety of workers, this may also require renovation of the workplace to meet the standards among others. Employers see such processes very costly that's why the transition process is very slow and unpopular in most developing countries. Evidence has shown that mostly the unorganized employers, SMEs and workers block the process due to various reasons like lack of appropriate information on the formalization process.

It is against the above background that this report recommends that workers representatives and stakeholders be trained on relevant instruments and information on the formalization process. Some of the key areas to be considered includes but not limited to the following:

- Recommendation 204, on transition to the formal economy.
- The Malawi decent Work Country Program (MDWCP)
- Sustainable Development Goals (SDGs)
- International labour Standards (ILS)
- Business registration and its conditions
- Labour laws and employment policies

5.1.2. Develop and promote relevant policies

Policies are key development documents that guide development processes, therefore it is important that appropriate policies are put in place and promoted in order to create an enabling environment for business growth and sustainable employment opportunities.

5.1.2.1. Access to affordable financial services

The cost of borrowing is very high in Malawi compared to other African countries like South Africa, Uganda, Tanzania, and Mozambique among others. The high interest rates are the main barrier to business and economic growth in Malawi. In addition, majority of the SMEs interviewed in this study indicated that poor access to financial services and low business capital are among the key barriers towards the formalization process (see Fin Scope Survey 2012 and 2019). It is therefore key to ease access to financial services in Malawi to aid the formalization process. It is therefore important that stakeholders campaign and advocate for the amendment of the Financial Bill Act- Interest Capping. Interest Capping has the ability to offer permanent and sustainable solution to financial challenges faced by firms and small borrowers in Malawi.

5.1.2.2. Boosting SMEs

Government and the private sector must put in place and implement deliberate procurement policies that should promote local MSMEs. For example, there is a need for policies to set threshold of contracts that MSMEs and Large and well established companies/businesses can participate. This would allow a fair completion of business for those providers from within a particular threshold. It is also key that government extend tax exemption policy to SMEs willing to formalize.

5.1.2.3. Implementation and enforcement of the existing policies

Cross boarder SMEs interviewed in this study registered concerns that they face various challenges that affect their day to day businesses, for instance overcharging of duty fees, confiscation of items without proper justification, giving of money to officials for favours, and women in particular expressed concerns regarding sexual harassment and demand for sex for favours from male officials. Therefore, it is necessary that cross boarder SMEs are made aware on the available policies and International labour Standards (ILS) like the National Gender Policy, Convention 190 on Violence and Harassment, Convention 189 on domestic workers and the Simplified Trade Regime (STR). These tools have the potential to protect and promote SMEs, domestic and other informal workers from various injustices within the sectors.

In addition, the increasing levels of businesses operated by foreigners in district and rural areas has created stiff competition for local SMEs hence making them more vulnerable to closure. Such behaviour by foreign businesses need to be discouraged since the Business License Act prohibits Investors or big companies to open small businesses in districts or rural areas. To address this challenge it is important that stakeholders work collectively towards identifying and implementing sustainable solutions towards such challenges for instance conducting joint labour inspection.

5.1.3. Joint Labour inspections

The labour Inspection convention of 1947 (No81) and C129 on labour Inspection (Agriculture) Convention of (1969) are in force in Malawi. And the Ministry of labour through the Inspectorate Department is responsible for undertaking workplace inspection. It is therefore key that as discussed in recommendation (1) that the identified stakeholders also be involved in a joint labour and business inspection which should regularly conduct both labour and business inspections to address challenges and gaps pertaining to labour and formalization process. For instance, issues of business registration and also assessing if SMEs and employers are complying with labour laws and conditions of formalization.

In addition, the inspections should be used to identify foreign businesses that are not allowed by law to operate small business in districts and rural areas. This joint inspection should involve the participation of all key stakeholders as identified above.

5.1.4. Education and skills development

Informality in Malawi is strongly associated with illiteracy and low levels of formal skills. Majority of the people interviewed demonstrated to have very low levels of education since some could not write their names. According to MCTU (2017) report and the Fin Scope Survey of (2012) found that informality is highly associated with low levels of education. It was further found that the low levels of skill and education negatively affect the performance of informal workers.



Need for skills development

Indeed, lack of entrepreneurship skills and knowledge is among the greatest barrier to business growth and access to loans. Therefore, this report recommends that SMEs in Malawi must be trained on specific business skills (*need for skills needs assessment*) for instance business planning and management, negotiation and bargaining, marketing, customer care and record keeping among others. These skills have the potential to grow SMEs in Malawi and become more productive. On the other hand, domestic workers in Malawi also need to be trained on labour laws, and skills required for the execution of domestic work. It is also important that all other stakeholders as identified in recommendation (1) be involved.

5.1.5. Awareness, Campaign and advocacy on formalization

Informality comes with its consequences both positive and negative and addressing informality is a non-debatable issue. However, experience has shown that most interventions have for so long focused much on addressing the consequences of informality mainly the decent work deficits like low pay, sexual harassment, lack of social protection and violation of employment conditions among others. It is therefore important that MCTU and its affiliate take an active role towards raising awareness on the key issues driving informality for instance ineffective government systems, substandard classrooms and low quality of education services especially in rural areas, Corruption, low employment and economic activities, and limited access to financial services among others.

Campaign and advocacy are relevant interventions towards the formalization process. Thus the study proposes the following areas of advocacy and campaign:

- Recognition of prior learning
- Implementation of recommendation 204

- Amendment of the Financial Bill Act (interest Capping)
- Promotion of the Malawi Country Decent Work Agenda
- Skills Development for informal workers and economic entities (SMEs and domestic workers)

5.1.6. Establish and strengthen union branches in rural and urban areas

Strengthening and increasing trade union visibility in rural and urban areas is among the key strategy towards addressing decent work deficits and the formalization of the informal economy. It is important for trade unions to establish and strengthen union branches in both rural and urban areas.



Katunga and Maseya Cooperatives (KAMA)

Trade unions in Malawi need to utilize the available opportunities for both membership growth and representation. One of the readily available opportunities is to establish links with cooperative and associations which are found in each and every part of Malawi, and according to the unconfirmed reports indicate that there are over 15,000 cooperatives and association in Malawi but only 440 are registered. According to the ministry of Trade of the 440 registered cooperatives membership is at 34,774.

Cooperatives and associations are already organised groups, but experience has shown that most cooperatives focus much of their attention on the business aspect of the group like finding better markets for their produces, rather than the labour laws and workers' rights. The low levels of knowledge and information on labour issues has exposed many cooperatives to decent work deficits and have made majority to operate in the informal economy. It is therefore key for trade unions especially MUFIs, CIAWU and TOTAWUM to organise cooperatives and associations. This is very key as it will allow trade unions to share relevant labour and business information with rural workers and SMEs working as cooperatives or associations.

This intervention might expose further labour and business knowledge gaps in the rural areas which is very important for promoting decent work and formalization process. It is therefore vital for such union branches to be equipped with relevant labour and formalization knowledge.

5.2. Conclusion

In conclusion, informality should be discouraged at all cost, since its implications go beyond the informal worker. It is therefore very critical for the government and stakeholders to provide alternatives to informality for instance, creating more sustainable and decent economic opportunities that should attract those in the informal or planning to enter the informal economy. In addition, there is also a great need to put in place various support systems that will help informal workers and entrepreneurs to transition to the formal economy. More important is the need to develop a well-coordinated approach, where all key stakeholders play a role towards formalization.

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