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Toward a Theory of the Informal Economy

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Abstract

Economic activity taking place within the informal sector—traditionally defined as activity unregulated by law but governed by custom or personal ties—represents an emerging frontier for management researchers with interests from alleviating poverty at the bottom of the economic pyramid to entrepreneurship, innovation, or organizational functioning in advanced knowledge economies. A substantial portion of the world's economic activity takes place informally, with many developing nations having more than one half of their output derived from the informal sector and the advanced economies witnessing an increase in informal economic activity. I review the literature in economics, sociology, political science and public policy, and management and show that defining the informal economy proves problematic; current definitions of the informal economy fail to converge around a unitary construct. I then use these disparities in the literature to generate a model of the informal economy clear enough to foster a distinct research agenda.

Introduction

> *Francis sells shirts on a busy street in downtown Accra, Ghana, where he has worked for several years. He buys shirts for about $1.50 each, has them adorned with silk-screened artwork for another $1.50, and sells the*

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finished product for between $3.50 and $5.50. Employees of the nearby Art Center—a state-sponsored competitor—constantly drive Francis off the sidewalk and attempt to confiscate his shirts. With no business license or other legal recourse, Francis can't stop these raids nor can he rely on the police for help; if the police come, they will likely shake him down just like the Art Center employees. Francis has little formal education, he finished junior high school, and has no capital; he is for all intents and purposes trapped into life as a street vendor. He earns between $15 and $20 per month.[1]

Abigail owns and operates two arts and crafts shops in Accra. Her shops have concrete walls and wooden doors, allowing her to stock merchandise from all over West Africa. She registered her shops with the local Metropolitan Authority and pays taxes; she also belongs to a recognized trade association. Her sister manages the second store, but the employees of both shops are paid in cash and are not recognized as formal employees by the State, thus avoiding a set of onerous employment regulations and related costs. Abigail would like to invest more capital into her buildings to enhance sales, but she lacks formal title to the property; in fact, neither Abigail nor the local government have any record of who owns the property. For many years, her stores have averaged between $3000 and $4000 per month in total revenue.[2]

Don Anderson spent his professional life as a shipwright. Don built, repaired, and maintained yachts and sailboats for a well-heeled clientele in California, Hawaii, and Washington. Don was a licensed private contractor and duly registered with the states in which he worked, paid all taxes and license fees, and complied with all applicable health and safety regulations. What he didn't do, however, was formally estimate costs or sign contracts with his clients. He would often open a joint checking account with his client, who would deposit money for Don to use in his work. At the end of the project, there would be some type of "settling up." Clients always paid Don's fees. Don Anderson was my father in-law.[3]

Simi, a middle-aged Navajo medicine woman, harvests, purifies, and markets native herbs for ceremonial purposes to Native Americans across the United States through telephone orders or in-person sales. She gathers the herbs and plants on private or public lands without permits and her business has no license. She keeps her business small, selling enough to meet her needs; selling in larger quantities would likely violate traditional production methods but certainly her beliefs about the role of material goods in life. Simi owns her own truck (worth several thousand dollars), but claims: "I'm not here to make money; I'm here to help people."[4]

How can shirt sellers like Francis, small shop owners like Abigail, Don Anderson's one-off exceptional organizational arrangements, or a Navajo medicine woman inform cutting-edge management scholarship? Because each of the cases above highlights an aspect of the informal economy; in what follows, I argue that the informal economic activity represents a significant new frontier for management scholarship and investigation. Those at the bottom (or base) of the economic pyramid (BOP) (Prahalad, 2005) or emerging markets (Wright, Filatotchev, Hoskisson, & Peng, 2005) operate in systems where informal activity predominates and research in these contexts stands as a vital new context for research and theorizing. At the very least, these environments provide extreme contexts in which to "stress test" management theories; they may, however, provide a fertile field rich in new insights and understandings. Informal economic arrangements, as defined below, also figure prominently in more mainstream areas of management research such as relational governance (e.g., J. H. Dyer & Singh, 1998) and entrepreneurship or innovation (Saxenian, 2000). Serious study of the informal economy may yield a "quantum theory" for management scholars, providing insights about economic and organizational activity at the very smallest and —paradoxically—the very largest scale (Turner, 2004).

Economists LaPorta and Schleifer (2008, p. 1) define the informal economy as "economic activity that [is] conducted by unregistered firms or by registered firms but hidden from taxation." Sociologists Castells and Portes (1989, p. 12) state: "the informal economy is . . . characterized by one central feature: it is unregulated by the institutions of society, in a legal and social environment in which similar activities are regulated." Venkatesh (2006) defines informal, underground, or "off the books" economic activity as characterized by either *illicit practices* (products or processes) or *illicit exchanges*. Economists focus primarily on the status of firms in their discussion of the informal economy; sociologists and many policy scholars such as Chen (2006, p. 76) "want to extend the focus to include not only enterprises that are not legally regulated but also employment relationships that are not legally regulated or protected."

Given its potential importance, however, the informal economy represents a problematic construct that defies easy definition. Despite the prima facie clarity of the above definitions, scholars such as Fortuna and Prates (1989) noted more than 20 years ago that defining the informal economy has always proved problematic and that definitions of the informal sector possesses heuristic value but little theoretical legitimation. Almost two decades later, Keith Hart (2006, p. 29), the economist credited with coining the term "informal economy," argued that modeling economic activity as being either formal or informal led scholars to "mistake the category for the reality it identifies," and that real economic activity proved far more complex than a simple categorization as formal or informal.

If the informal economy proves difficult to define, measuring its scope and impact presents a problem as well. Bhattacharyya (2004) and LaPorta and Schleifer (2008) outline the difficulties inherent in measuring the informal or “hidden” economy; however, in spite of the difficulties, the International Labor Organization (ILO) presents reliable data on the economic scale of the informal economy in many countries: 48% of workers are employed in the informal economy in North Africa, 72% in Sub-Saharan Africa, 51% in Latin America, and 65% in Asia (ILO, 2002). For the developed world, proxied by the United States, Sassen-Koob (1989) presents data showing that up to 90% of some construction sub-trades in New York City occurred “off the books.” More recently, Vogel (2006) cites statistics from LA County showing 679,000 undocumented workers, or 15% of the County’s total employment in 2004.

The scope of organizations competing informally includes individual street sellers like Francis up to and including very large formal organizations that, like Abigail or Don Anderson, may choose not to comply with laws and regulations or prefer to structure transactions informally. The domain of the informal economy covers a conceptual area from the dusty developing country bazaar to the pristine developed country boardroom (Guha-Khansnobis, Kanbur, & Ostrom, 2006; Turner, 2004; Zinnes, 2009). Finally, and perhaps most importantly, the reality of business activity in the informal economy encompasses a range of values considered traditional to management scholars—profit seeking, rational, marginal decision making—and traditional values such as the role of family in business, theology, and ethical norms and customs. A serious consideration of informal economic activity must consider not only how people choose to structure their transactions and lives but also recognize that many choose to do so based on conscious values-driven criteria rather than economic necessity or advantage.

This paper provides a comprehensive, but not exhaustive, review of existing modeling and thinking about the informal economy in economics, sociology, and management. The review aims to provide scholars with a solid conceptual background and understanding of why Sindzringre (2006, p. 58) could claim that the “plurality of meanings and instruments [for defining and measuring the informal economy] calls into question the concept’s validity.” My multidisciplinary review illustrates common views among scholars but also important areas of difference where theory and research can make new and meaningful contributions, especially for the science of management. I build from the existing literature and argue that what the field needs is not another definition but rather a model of the informal economy capable of generating testable hypotheses and a coherent research agenda. I conclude with a sketch of a potential research agenda informed by several key questions around the issues raised in the opening cases.

Literature Review

The conceptual terrain of the informal economy includes several academic disciplines, and the construct spans several levels of analysis, from micro-level concerns with knowledge, skill, and management ability through the macro-level issues of organizational form, competitive advantage, and institutional setting to the meta-level national and international issues of tax, education, and legal policy (see LaPorta & Schleifer, 2008, for a sample of relevant questions at each level). To delimit the discussion—in the spirit of a comprehensive rather than exhaustive review—my efforts will focus on issues of interest to macro-organizational scholars. Micro- and meta-level issues should not be ignored; however, editorial demands, as well as competence, argue in favor of a more limited view.

I further delimit the scope of the work by explicitly eliminating two closely related types of non-formal economic activity: domestic and criminal economic activity. Most work in the domestic economy qualifies as informal, based on Venkatesh's notion of illicit exchange—having one's children do chores would violate several laws and regulations if such activity occurred outside the home. I exclude domestic work, defined as work done informally but where output is confined to use within the household and not the marketplace (Booth, 1993). The domestic economy operates under the paradigm of autarky or sufficiency rather than exchange or maximization. I define the criminal economy as illicit practices or exchanges that violate formal criminal statutes rather than violations of civil law, excepting the payment of taxes in political entities where tax evasion represents a criminal rather than civil offense.[5]

Table 1 provides a summary of the literature on the informal economy, organized chronologically within each academic discipline. The structure of Table 1 should provide readers with a sense of the core conceptions of the informal economy, as well as an opportunity to see how those concepts evolved over time. I have tried to include the seminal early pieces, such as Lewis's writings in economics and Polanyi's in sociology, that appear time and again as the foundational pieces. My discussion in the text considers the literature according to the framework suggested by Becker (2004)—whether scholars focus on the *dualistic* nature of the informal as opposed to the formal economy, view the informal economy in a subservient *structural* role to formal economic activity, or consider the role of states in creating the *legal* contexts that define membership and migration within the informal economy. As I outline below, each perspective highlights different features of informal economic activity and each gives rise to different challenges and nuances of theory and research.

The Dual Economy Model

W. A. Lewis (1954/1958) developed the dual economy model, known today as both the dual economy and Lewis model (Ray, 1998), to explain economic growth, primarily in the third world. The model would secure a Nobel Prize for Lewis in 1979. The model envisions two de facto economic systems

Table 1 Defining the Informal Economy

Author(s)	Year	Discipline	Key Variable Definition
Economics			
Lewis	1954/ 1958	Labor supply	p. 407: "The capitalist sector is that part of the economy which uses reproducible capital, and pays capitalists for the use thereof . . . The subsistence sector is by difference all that part of the economy which is not using reproducible capital. . .." p. 409: "So the economy is frequently lopsided in the sense that there is excessive investment in some parts and underinvestment in others."
Hart	1973	Bureaucracy	p. 68: "the key variable is the degree of rationalization of work—that is to say, whether or not labor is recruited on a permanent and regular basis for fixed rewards."
Santiago and Thorbecke	1988	Status of labor	p. 128: "The formal sector employs wage labor, while the informal sector uses self-employed and unpaid family labor." (Puerto Rico)
Meagher	1990	Economic sophistication	p. 80: "The study of the parallel (and informal) economy suffers from three distortions: 1. Informal activity arises from distortions in the formal economy and is of recent origin (in fact, informal markets have existed for centuries based on culture) 2. Informal activity focuses on smuggling export crops (in fact, the market trades many primary foodstuffs, minerals, and has a currency exchange system) 3. Informal economies based on barter (in fact, sophisticated currency and exchange markets exist to price cross border trade)."

Marcouiller and Young	1995	Property rights, legal protection	p. 631: “the informal sector comprises producers who avoid taxes by bypassing the procedures [government-sanctioned procedures for establishing and recording property rights and for resolving disputes], thereby foregoing any claim on the order provided by the government.”
Francois	2002	Traditional technologies	p. 14: “the process of industrialization [entails] the transformation of economies from the use of less productive or traditional technologies to modern ones.”
LaPorta and Schleifer	2008	Legal registration, taxation	p. 1: “unofficial economic activity . . . that conducted by unregistered firms or by registered firms but hidden from taxation.”
Sociology			
Polanyi	1957	Institutional origins	p. 250: “the human economy, then, is embedded and enmeshed in institutions, economic and noneconomic. The inclusion of the non-economic is vital. For religion or government may be as important for the structure and functioning of the economy as monetary institutions or the availability of tools and machines themselves the lighten the toil of labor.”
Geertz	1963	Traditional versus modern production	p. 30: “The Pasar (probably from the Persian ‘Bazaar’ by way of Arabic) or traditional market, is at once an economic institution and a way of life, a general mode of commercial activity reaching into all aspects of Modjukuto society, and socio-cultural world nearly complete in itself.”
Castells and Portes	1989	Institutional regulation	p. 12: “The informal economy is . . . characterized by one central feature: it is unregulated by the institutions of society, in a legal and social environment in which similar activities are regulated.”

Table 1 Defining the Informal Economy (Continued)

Author(s)	Year	Discipline	Key Variable Definition
Sassen-Koob	1989	Labor markets	p. 73: "Informal work in this instance represents an acute example of exploitation."
Portes and Sensenbrenner	1993	Social "embeddedness" and social capital	p. 1329: "A solidary ethnic community represents, simultaneously, a market for culturally defined goods, a pool of reliable low wage labor, and a potential source for start-up capital." p. 1333: "New York hosts several formally registered Dominican finance agencies (financieras), but, in addition, networks of informal loan operations grant credit with little or no paperwork."
Venkatesh	2006	Illicit exchange and illicit activity	p. 7: "we cannot truly understand the 'shady' economy if we see it is as a dirty, lawless world of violence and disrepute, one that tarnishes an otherwise pristine sphere where everyone pays their taxes, obeys the laws, and turns to the government to solve disputes and maintain order ... Its [the informal economy] boundaries are not so clear. Nor, for that matter, is the underground economy inhabited by a single, distinct class of citizens."
Centeno and Portes	2006	Relationship with state	pp. 26–27: A final alternative definition of the informal economy would be transactions where the state neither provides protection nor receives a 'cut' ... therefore, the relationship between the informal economy and the state is, by definition, one of inevitable conflict."
Policy/Political Science			

Gaughan and Ferman	1987	Personal ties	p. 16: "Informal activity takes place largely in personal and intimate domains . . . reflect[ing] the nature of the personal ties between the participants, defined by norms and institutions that are in essence non-economic."
Henry	1987	Registration, scale, labor intensity, face to face relationships	p. 140: "informal economies seem to share the following characteristics. They are 1) concealed from the state accounting system and are largely unregistered by its economic and criminal measurement techniques; 2) small scale; 3) labor intensive, requiring little capital, and 4) locally based, with trading taking place through face-to-face relationships between friends, relatives, or acquaintances in a limited geographic area."
deSoto	2000	Legal/institutional basis	p. 21: "Once these newcomers to the city quit the system, they become 'extralegal.' Their only alternative is to live and work outside the official law, using their own informally binding arrangements to protect and mobilize their assets."
International Labor Organization	2002	Status of labor	p. 12: "the informal economy is seen as comprised of informal employment (without secure contracts, worker benefits, or social protection) both inside and outside informal enterprises . . . (small, unregistered or unincorporated enterprises)."
Becker (Swedish International Development Cooperation Agency)	2004	Labor	p. 11: "The informal economy is largely characterized by: Low entry requirements in terms of capital and professional qualifications; a small scale of operations; skills often acquired outside of formal education; Labor intensive methods of production and adapted technology."

Table 1 Defining the Informal Economy (Continued)

Author(s)	Year	Discipline	Key Variable Definition
Chen	2006	Labor/employment	p. 76: “the informal economy is comprised of all forms of ‘informal employment’—that is, employment without labor or social protection—both inside and outside informal enterprises, including both self-employment in small unregistered enterprises and wage employment in unprotected jobs.”
Zinnes (Donor Committee for Economic Development)	2009	Institutional capacity	p. vii: “a firm [that] operates in the informal economy [sic] is unable to take full advantage of the legal, financial, and marketing benefits that, in principle, the judicial, banking, and economic systems of its country offer.”
Management			
Barnard	1938	Organization	p. 115: “by informal organization I mean the aggregate of personal contacts and interactions and associated groupings … informal organization is indefinite and rather structureless.”
Boisot and Child	1996	Interpersonal relationships	p. 604: Chinese business exhibits “a preference for interpersonal accommodation … the process is self-reinforcing in that the absence of a rational-legal institutional framework fails to engender confidence in a wider system of bureaucratic or market transacting outside networks based on personal power, commitment, and trust … [we] labeled this tendency the ‘iron law of fiefs.’”
Apressyan	1997	Illegal products—ethical implications	p. 1563: “the shadow economy was based on more entrepreneurial and efficient business. However, since it was dependent upon illegal usage of state material and financial resources, or thefts, it was essentially parasitic by its character.”

Chakraborty	1997	Clandestine sales, inflated prices—ethical implications	p. 1530: "The phrase 'black market' rolled into circulation during the Second World War and has remained since that time. It denotes the process of clandestine sale of scarce, rationed, controlled commodities at inflated prices." (India)
Thomas and Mueller	2000	Labor intensity registration	p. 288: "In less developed countries . . . new ventures tend to be more labor intensive thereby creating job opportunities." p. 293: "Many entrepreneurs do not ever register their businesses, especially in the developing world where they might be subjected to the impediments that governmental bureaucracies often impose."
Spicer, McDermott, and Kogut	2000	Socially embedded ties	p. 639: "Informal networks of local firms . . . [characterized by] dense horizontal socioeconomic ties emerged to help managers and work teams, suppliers and customers, firms, and local party members coordinate continual adaptations to the shortage environment."
Hudson and Wehrell	2005	Regulatory control—ethical implications	p. 288: those in the informal economy avoid "various regulations to which they might otherwise be subject. The regulations they avoid may include labor legislation concerning wages and safe working conditions, business registration, zoning restrictions with regard to commercial locations, licensing requirements of various sorts and even business tax obligations."
Nwabuzor	2005	Burdensome governments—ethical implications	p. 126: "Informality is a response to burdensome controls, and an attempt to circumvent them."

Table 1 Defining the Informal Economy (Continued)

Author(s)	Year	Discipline	Key Variable Definition
London and Hart	2004	Social embeddedness	p. 352: "In the developing world, on the other hand, it is simply too costly or complicated for many entrepreneurs to enter the formal economy . . . In the informal economy, relationships are grounded primarily on social, not legal, contracts."
Li, Zhou, and Shao	2009	Interpersonal ties	p. 342: "in emerging economies . . . firms must rely on informal institutional constraints, such as interpersonal ties, to facilitate their economic exchanges."
Webb, Tihanyi, Ireland, and Sirmon	2009	Legality	p. 492: "We define the informal economy as the set of illegal yet legitimate (to some large groups) activities through which actors recognize and exploit opportunities."

operating in a country: a formal and an informal sector. The formal sector comprises economic activity largely in urban areas and features wage labor, capital-intensive firms, and high marginal productivity that create incentives for capitalists to invest in labor and machinery. The informal sector operates primarily in rural areas and features low wages and labor-intensive firms/actors. The informal sector persists primarily because the efficiencies of formal production have yet to displace more traditional, family or Oikos, forms of economic organization. Importantly, labor in the informal economy produces with zero marginal productivity primarily because surplus labor exists. Lewis writes:

> In the first place, an unlimited supply of labor may be said to exist in those countries where population is so large relatively to the capital and natural resources, that there are large sectors of the economy where the marginal productivity of labor is negligible, zero, or even negative. Several writers have drawn attention to the existence of such "disguised" unemployment in the agricultural sector, demonstrating in each case that the family holding is so small that if some members of the family obtained other employment the remaining members could cultivate the holding just as well. . . The phenomenon is not, however, by any means confined to the countryside. Another large sector to which it applies is the whole range of casual jobs—the workers on the docks, the young men who rush forward asking to carry your bag as soon as you appear, the jobbing gardener, and the like. (Lewis, 1954/1958, p. 402)

In violation of strict marginalist thinking, surplus labor is not paid at its marginal productivity, zero; however, subsistence wages prove to be so far below the marginal productivity of labor in the formal sector as to create an unlimited supply of labor willing to move from the informal sector. Given an unlimited supply of labor, capitalists in any period can profit from investments that exceed the marginal value of its factory labor. These profits could be reinvested in further improvements in marginal productivity without the accompanying rise in wages; this process marches forward until the practical end of the surplus would be employed and wage costs must rise. One important implication of the Lewis model, one contradicted by reality, is the self-liquidating nature of informal activity, as the formal sector continues to expand until it has exhausted the excess labor supply. Economies typified by large informal sectors, such as sub-Saharan Africa, grow slowly if at all and continue to have a sizable stock of informal labor (Easterly, 2001, 2006; Ray, 1998). The critical vestigial remain of Lewis's work, however, would be the enduring notion that economic activity could be, and perhaps should be, modeled as a dual sector phenomenon, with a formal and informal sector.

K. Hart (1973), based on his work in Accra, Ghana, noted that Lewis's model didn't hold. Instead of finding an endless stream of labor flowing from the rural, low-productivity sector into the urban and formal sector, he found a symbiotic dual urban economy: a limited formal sector and a thriving urban informal sector, as well as a third, criminal sector. Hart actually coined the term informal economy, and he noted that the two economies had quite a number of bidirectional flows and interactions as individuals moved between sectors, but that the proximity of the low-productivity subsistence sector did not fuel investment and productivity in the formal sector. Instead, he found an informal sector that helped many buffer the ups and downs of employment in the formal economy.

More recent scholarship has extended the Lewis model by bifurcating the formal and informal sectors into rural and urban locations and has noted with Hart the symbiotic and coextensive nature of the two sectors (Gong, van Soest, & Villagomez, 2004; Paul & Barbato, 1985; Santiago & Thorbecke, 1988). Economists, particularly development economists, continue to position the informal sector as inefficient due to small scale and the lack of property-rights protection compared to an efficient formal one (e.g., LaPorta & Schleifer, 2008; Marcouiller & Young, 1995). Much of the work in economics focuses on the efficiency losses that come with a thriving informal sector such as lost tax revenues and the pricing and consumer inefficiencies that accompany the lack of scalability of informal businesses.

Labor economists also examine the existence of the informal economy and its effect on both skill acquisition (LaPorta & Schleifer, 2008) and the choice of where workers will perform their labors (Maloney, 1999), including the effects earning potential in either sector (Blanchard & Katz, 1999) and sectoral influences on the employment of women (Tiefenthaler, 1994). Torrey, Smeeding, and Bailey (1999) find that informal activity in Central Europe under communism provided a source of income skewed toward the upper classes. In a modern redux of the Lewis model, Cuddington (1993) sees the informal sector providing surplus labor that helps countries afflicted by the AIDS epidemic maintain economic growth and prosperity.

Meagher (1990) identifies that the *practical* economy violates three key *theoretical* assumptions of the dual economy model: that informal activity exists as a modern and temporary phenomena due to distortions in the formal macro-economy of countries (in fact the informal economy predates formal activity (Booth, 1993; Geertz, 1963; Turner, 2004); informal activity consists of contraband trades outside the formal sector (in fact a number of very legitimate items from foodstuffs to crafts trade in the informal economy); and informal trades occur through barter rather than money (in fact money constitutes the primary form of exchange and many informal markets even feature foreign exchange services and rates).

Polanyi (1957) identified a crucial difference between the substantive economy, how people actually engage in production and exchange, and the formal economy, how economists modeled this activity. The dual economy model provides an excellent example of how formal economic theory fails to explain the real processes individuals and organizations use to create and trade goods with economic value. Dual economy scholars correctly categorize informal enterprises as primarily small-scale and undercapitalized (in terms of both human and financial terms); they have failed to create a viable explanation for the persistence of informal economic activity except as a distortion caused by inefficiencies in the institutional or political structure of countries. Explanations about persistence come from sociologists or policy scholars, and I consider their contributions next.

The Structural Informal Economy

Fortuna and Prates (1989, pp. 78–79) describe the structuralist perspective:

> Interpretations of the informal sector which have captured the attention of academicians and planners since the seventies 1970s grew out of dualist approach. From the beginning, emphasis was not placed upon a structural understanding of chronic unemployment and poverty, the articulation between national and international levels, the styles of development adopted by individual countries, or the effects of the international division of labor. Instead, the problems of underdevelopment were attributed to the existence of one single sector (not a whole system) which had to be transformed...
>
> In contrast with sectoral and dualistic approaches we maintain the need to conceptualize informality as a particular relationship in the organization of production. In other words, a central idea of our study is that informality is a feature of labor-capital relations ... informal labor relations are distinguished primarily by a process of de-institutionalization of productive activities through a movement away from regulations issued by the state.

The structuralist vision of the informal economy builds on Wallerstein's (1974/2007) world systems model, and pictures the duality existing between a formal *core*—of a national economy or among nations—of high wage, high productivity economic activity, and an informal *periphery*—again within or among nations—of low wage, low productivity economic activity. "Some countries were stronger than others economically (the core) and therefore able to trade on terms that allowed surplus-value to flow from the weaker countries [or regions] to the core" (p. 12). Maloney (1999, p. 276) argues that workers in the core "enjoy high wages, social security, vacation, pension, and employment security ... by contrast, those unable to find work in such firms resort to the next best alternative, the so-called 'informal sector,' in small firms or self-employment, engaged in labor-intensive activities, without job security or benefits." The rich formal sector extracts value from the poor informal sector in ways that lock in the persistence of an inequitable world system. This exploitative relationship between, metaphorically, labor and capital explains the persistence of the informal economy.

Not all sociological scholarship on the informal economy adopts this somewhat radical structuralist orientation. Polanyi (1957) focused on the embedded nature of economic activity within a larger social system, and Banfield (1958) clearly identified how such embeddedness could preclude economic development and formalization. Geertz (1963) reached a different conclusion using the same foundation of embeddedness; he showed how the underlying social structure and organization of a (primarily) informal community would affect the ensuing formalization of activity and define different development tracks.

Organizational and institutional sociologists picture the structural arrangements in the informal sector drawing on tradition, while the formal sector relies on Weber's rational/legal forms of legitimate authority (e.g., Castells & Portes, 1989; Fukuyama, 1995). Coleman (1988) sees informal organization and economic activity as a core source of economic social capital. Informal activity structurates invokes and reinforces important cognitive and normative social structures, thus helping them remain vibrant, current, and effective (Sewell, 1992). Putnam (2000) argues that such norms serve bonding (intrinsic), as well as bridging (instrumental), roles in social life, making life more meaningful, as well as more efficient. Fukuyama (1995) and Portes and Haller (2005), following Banfield (1958), focus more on the instrumental role that the norms, values, and customs that arise from traditional or informal activities play in creating and sustaining strong economies.

Portes and Sensenbrenner (1993) bring together the emergent writing on social capital with notions of embeddedness to identify both positive and negative aspects of the informal sector. Structurally isolated immigrant communities in cities such as Miami and New York City often represent "simultaneously a market for culturally defined goods, a pool of reliable, low-wage labor, and a potential source for start-up capital" (Portes & Sensenbrenner, 1993, p. 1329) through informal mechanisms such as rotating credit associations or other lending arrangements. New York, for example, "hosts several formally registered Dominican finance agencies (financieras) but, in addition, networks of informal loan operations [that] grant credit with little or no paperwork" (Portes & Sensenbrenner, 1993, p. 1333). Informal economic arrangements provide immigrant communities with advantages such as reliable suppliers and buyers, low-cost financing, and flexibility in meeting new or changed conditions. Portes and Sensenbrenner (1993) note, however, that such informal arrangements extract costs in terms of both community solidarity and individual freedom.

Venkatesh (2006) elaborates the complex and nuanced advantages and drawbacks arising through informal economic activity in his in-depth analysis of socioeconomic structure in Chicago's South Side ethnic neighborhoods. The community, primarily composed of African-Americans but increasingly populated with other ethnic minorities, exists as an almost separate world from mainstream, formal Chicago. He notes that informal activity bestows blessings on the citizens of the community in that informal activity allows them all to scratch out a living because few, if any of them, could compete effectively in the formal economy. Living "off the books" also curses the community, however, as the lack of legal and regulatory protection gives undue power to criminal elements (i.e., gangs) and gives the community few slack resources (social and economic) to deal with negative shocks. His conclusion summarizes the complexity and nuance of the informal economy, as seen from the structuralist paradigm:

> The underground economy enables poor communities to survive but can lead to alienation from the wider world . . . On the one hand, the underground economy is a space forged by exclusion from the social mainstream. Much of the reason for lending to one another, hiring off the books, and solving crimes without the aid of the police is that banks discriminate against the poor, mainstream employers and unions do not do effective outreach to the poor and minorities, and law enforcement does not provide adequate service to the inner city. On the other hand, however meaningful and satisfactory it may be for those involved, this kind of adjustment does little over time to bring about improvement in credit availability, labor force participation, and policing. It does little to leverage more stable and productive relationships with the institutions of the wider world . . .
>
> Living underground largely means creating ties of dependency to other actors who are equally hard up. Poor people sharing with other poor people has its limits. Their resources run out at some point. The economy becomes predatory, and hustling shows its ugly side, not as creative and explorative, but as exploitive and punishing. (Venkatesh, 2006, pp. 385–386)

Legalism and Government Regulation

Becker (2004, p. 10) describes the legalist view of the existence and persistence of the informal economy as arguing that "informal work arrangements are a rational response by micro-entrepreneurs to over-regulation by government bureaucracies." Legalism focuses on the policy and institutional reasons individuals choose to compete formally or informally. Legalists differ from dualists in that dualists see informality in the deep structure of economic roots (i.e., the marginal value of surplus labor), while legalists posit informality arising primarily from institutional preferences and arrangements. Legalists differ from structuralists, as the latter see informality as an imposed constraint, while the former model participation in the informal economy as a free choice. The way out of the informal economy, then, lies in creating institutions and incentives, and removing relevant barriers, that encourage (discourage) formality.

Social activist and policy scholar Hernando deSoto (2000) typifies the legalist position. DeSoto creates a link between informality, poverty, and the legal systems in many developing countries. People compete in the informal economy because either formal laws (such as property-rights protections) or institutional procedures (e.g., business registration requirements) make it impossible, or practically so, to join the formal economy. The lack of property rights means that informal entrepreneurs and squatter homeowners lack title to their lands, which in turn prevents them from collateralizing their property and funding growth through bank loans. Similarly, onerous business registration practices, required licensing procedures, and bureaucratic approvals stymie movement from the informal sector. For example,

> We have found that throughout the Third World [...] the legal system imposes rules that thwart the expectations of those it excludes ... Many countries make the obstacles to entering the legal property systems so daunting and expensive that few migrants could ever make their way through the red tape—as many as fourteen years and seventy-seven bureaucratic procedures at thirty-one public and private agencies in Egypt, and nineteen years and 176 bureaucratic steps to legalize the purchase of private land in Haiti. (p. 83)

He goes on to explain, however, that exclusion from formal participation raises the costs of doing business, creating a double penalty for entrepreneurs and households trying to compete informally.

> If there are costs to becoming legal, there are also bound to be costs to remaining outside the law. We found that operating a business extralegally includes paying 10 to 15 percent of its annual income in bribes and commissions to authorities. Add to such payments the costs of avoiding penalties, making transfers outside legal channels, and operating from dispersed locations and without credit, and the life of the extralegal entrepreneur turns out to be far more costly and full of daily hassles than that of the legal businessman. (p. 83)

Di Tella, Galiana, and Schargrodsky (2004) consider a natural experiment that tests some of deSoto's (2000) notions about the costs of competing without property rights. They describe the setting:

> More than 20 years ago, a large number of squatter families occupied an area of wasteland in the outskirts of Buenos Aries, Argentina, thinking it was State property. In reality, the area was made up of different tracks of land, each with a different legal owner. An expropriation law was subsequently passed, ordering the transfer of land to the state (in exchange for monetary compensation). The purpose of the law was to allow the state to later transfer ownership to the squatters. However, only some of the original legal owners surrendered the land, while other chose to contest the expropriation law. Give the slow functioning of the Argentine courts, the dispute between the state and the owners who challenged the expropriation law has not been settle to this date, resulting in weak property rights to squatters who happened to settle on a parcel of land on these tracts. Thus, a group of squatters obtained full property rights, while others are currently living on similar parcels but without legal titles. Since the decision to challenge the occupation was orthogonal to the characteristics of the squatters, the allocation of property rights amongst these squatters is exogenous. (p. 3)

Their natural experiment yielded the insight that "property rights make beliefs closer to those that favor the workings of a free market" (Di Tella, Galiana, & Schargrodsky, 2004, p. 1). Perhaps a change in cognitive status vis-à-vis capitalist economics proved the greatest outcome of a change in legal status. A number of other scholars have investigated how changes in the legal/regulatory environment affect participation in informal economic activities (Besley & Burgess, 2004; Zinnes, 2009). Perdomo (1990) in Venezuela, Lemieux, Fortin, and Frechette (1994) in Canada, and Piggott and Whalley (2001) in Canada all show that regulatory change tilted against business (e.g., labor-friendly, tax increases) caused actors to leave the formal economy and participate in informal activity instead. Legalists broadly consider how laws and institutions change hearts, minds, and behaviors of economic actors.

Business ethicists take a decidedly legalistic view. Some see the informal economy as a source of unethical business behavior that tends to undermine the rule of law (e.g., Argandona, 1999; Nwabuzor, 2005). Argandona (1999), for example, describes the insidious effect of the informal (i.e. grey) market in Spain, as informal activity contributes to corruption and a weakened respect for the rule of law, primarily through tax evasion by both firms and laborers. Others approach the informal economy with a more balanced view, noting both the benefits and costs of off-the-books activity. For example, Apressyan (1997, p. 1563) notes the contradictory nature of informal economic organization in Russia: "The shadow [informal] economy was based on more entrepreneurial and efficient business. However, since it was dependent upon illegal use of state material and financial resources, it was essentially parasitic by its character." Avtonomov (2006) estimates that 30–40% of small businesses in Russia—post-reform in the early 1990s—operated informally. Bohata (1997, p. 1573) traces the smooth development of post-1989 capitalism in the Czech Republic in large measure to the existence and persistence of "small entrepreneurs who transformed into the black or shadow economy in the 1950s and 1960s." Bhattacharyya and Ghose (1998) note that informality may be a response to endemic state corruption as much as a cause: foreign firms in India avoid reporting sales and income in order to avoid the far-reaching tentacles of corrupt police, tax, and administrative officials.

In a related vein, I consider the role of values in driving participation in informal economic activity under the broad rubric of legalism. Simi's case in the introduction illustrates informal economic organization driven by a values-based subsistence logic: Simi sells to live, she doesn't live to sell, and to sell more, aside from creating an unnecessary surplus, would violate her deeply held moral norms and world view. Farella (1984) describes the normative institutional context Simi operates within: in Navajo culture, profit making carries very negative connotations, including accusations of witchcraft. Simi's deep belief is that the herbs and plants she sells have not only medicinal and spiritual qualities, but spirits as well. To sell more just to make more would violate nature and offend the spirits. Whether one holds the same belief system or not, one cannot deny the role of ethical norms and religious values in Simi's choice of economic organization.

Banfield (1958) and Gabriel and Cornfield (1995) identify another set of normative values inconsistent with institutional participation: a preference for dealing with family members and a distrust of institutions and institutional actors. Legal registration and the formalization of the business that it entails may be viewed as a signal of low trust among family or tribal members. For cultural groups without a preexisting preference for contract and institutional participation, the move to contract that legal registration implies communicates a lack of trust and a repudiation of family norms. Bosoit and Child (1996) see the quasi-legal nature of Chinese kinship relations as this kind of substitute control mechanism for participation in the formal legal system.

Maloney (1999) highlights another normative motivation in the desire of some individuals for a high degree of autonomy and control. Such desires contribute to the persistence of both external noncompliance (the rejection of societal intrusions into personal autonomy) and tradition-based governance (where bureaucracy becomes a substitute for personal control). For some potential employees, particularly those living within subsistence paradigms, working in a rational bureaucracy becomes anathema, and these workers naturally gravitate to organizations offering more flexible arrangements. Part-time workers, or those in hobby businesses, may also exhibit a strong preference for informal work arrangements.

The strength of legalism lies in its focus on the larger institutional environment and its ability to create conditions conducive to either formal or informal economic activity, as well as the role of individual actors in responding to institutional incentives. My insertions to the legalistic framework include the role of beliefs, values, norms, and customs as important determinants of the "location" of economic activities. The weakness of the strict legalist view comes from its focus on the regulatory institutional framework, but the exclusion of cognitive and normative institutions, in determining the size and persistence of the informal economy (Scott, 2008); as Channell (2008) notes, changing the cognitive and normative foundations to create effective laws requires time, patience, and directed effort.

Management Theory and the Informal Economy

Management scholars build, not surprisingly, on the work of both sociologists and economists; thus management scholars tend to look at both the dualistic nature of informal economic activities and their fundamental interconnectedness (Barnard, 1938). Consistent with the overall theme of strategic management, many scholars ask and then answer the question of how informal economic activity can lead to competitive advantages. Barney and Hansen (1994) and Hosmer (1994) write about the competitive value of trust—a key governance feature of informal economic activity—and how very advanced firms can win in their markets by becoming distinctly less formal. J. H. Dyer and Singh (1998) articulate the "relational view," premised on the notion that relationships and transactions between parties ungoverned by contractual specification may give rise to competitive rents. Spicer, McDermott, and Kogut (2000) describe the powerful role informal economic arrangements played in the transition from command to capitalist economies in Eastern Europe.

Peng (2003) and his colleagues (e.g., Peng & Heath, 1996; Peng & Lou, 2000; Peng & Shekshnia, 2001) outline the challenges and pitfalls for multinationals in economies moving from traditional to rational institutional structures. Khanna and Rivkin (2001) outline the role of business groups, collections of firms combining formal and informal elements and commitments, in compensating for the lack of formal regulatory institutions in 14 emerging markets. Carrera, Mesquita, Perkins, and Vassolo (2003) provide a more detailed account of how Argentine business groups provided flexibility for member firms in the face of severe environmental turbulence.

Management scholars have also looked at intra-firm uses of informal organization. Lazzarini, Miller, and Zenger (2004) find, for example, that in businesses that are already formalized, the desire for contractual safeguards and legal protections does not hamper or impede social relationships. For some cultural groups, however, without a preexisting preference for contract and institutional participation, the move to contract that legal registration implies communicates the lack of trust and a repudiation of family norms. Bosoit and Child (1996) see the quasi-legal nature of Chinese kinship relations as this kind of substitute control mechanism for participation in the formal legal system. Finally, Acquaah (2007) examined how managers in Ghana—an emerging or developing economy—relied on informal social capital as a key method for gaining access to critical resources to grow their businesses. He notes the stickiness of informal arrangements and ways of doing business, even though the managers he studied all worked for firms competing in the formal economy.

S. L. Hart (2007) and London and Hart (2004) take the informal economy as a starting point in considering the role of strategy for capitalism at the crossroads of social sustainability. Prahalad's (2005) call to focus on the bottom of the economic pyramid necessarily means understanding how the informal economy works. The management literature appears to have borrowed the concept of informal economy quite broadly and has paid little attention to the nuances of the definitional problems of the construct and establishing limits and boundaries to the nature and notion of an informal economy. A close reading of this literature implies contradictions. The dualists see informal economic activity as a temporary aberration, yet it persists and even grows over time. Structuralists argue that the informal economy oppresses individuals and classes yet see in informality a flexible and adaptive arrangement; legalists see the informal economy through an important regulatory lens but often fail to acknowledge the critical supporting role of norms and worldviews.

If the informal economy represents a nascent, and potentially powerful, research context for management, then it behooves management (as a field) to create a robust, grounded, and workable model of the informal economy if we hope to avoid many of the contradictions plaguing other scholars. In what follows, I hope to lay the groundwork for such a model. The next section re-sorts the literature based on common themes across the disciplines of focus. I then outline a model of the informal economy and highlight some natural questions for theoretical and empirical development.

Motivations for Competing Informally

A closer reading of the literature presented in Table 1 suggests that the variations on the themes considered by economists, sociologists, policy scholars, and management writers—if taken as a collective whole—suggest common elements in defining the informal economy. If one rearranges Table 1 around highlighted features of the informal economy, authors tend to emphasize one of two core features of informal economic arrangements: they focus on either legal status of activities or exchanges to cut at the joints between formal and informal economic activity *or* on the use of bureaucratic or non-bureaucratic forms of organization and governance (for legal status examples, see

DeSoto, 2000; Henry, 1987; Hudson & Wehrell, 2005; Thomas & Mueller, 2000; Webb, Tihanyi, Ireland, & Sirmon, 2009. For non-bureaucratic authority examples, see K. Hart, 1973, 2006; Li, Zhou, & Shao, 2009; Meagher, 1990; Spicer et al., 2000).

The various manifestations of legal status and organizational form collapse into two broad dimensions: *external compliance* (legal status) and *internal governance* (organizational form). Rational organization—in the pure Weberian sense—appears to presume a particular legal status thus depriving the dimensions of pure orthogonality. However, Parsons (1947) argues that the basis of rational authority comes from a process or procedure that consciously enacts or adopts rules and authority as opposed to accepting those in authority as always having possessed it. Informal organizations without legal status and standing (e.g., gangs) may in fact use explicit and conscious procedures such as elections or tests to legitimate the authority structure (Venkatesh, 2006). Table 2 describes the formal and informal sectors based on these dimensions.

Table 2 begins to reveal the complex and multifaceted nature of formal and informal economic activity. Take the dimension of legal compliance, for example. Firms may comply with *all* laws and regulations (taxes, fees, employment regulations, materials and safety regulations, packaging and marketing regulations, etc.) at various levels of government; firms may comply with *some* regulations by either conscious choice or unconscious omission; or firms may choose to comply with *none*. Abigail's case in the introduction exemplifies the middle path. What LaPorta and Schleifer (2008) model as a dichotomous choice (compliant/noncompliant) breaks out upon further investigation to be a continuum of compliance options. Indeed, if membership in the formal economy requires complete compliance with all national, regional, and local laws and regulations, the population of "formal" firms, even in an advanced industrial economy, should be much smaller than the number of legally registered firms, as firms may fail to comply with laws and regulations either out of guile (Williamson, 1985), ignorance, or merely misunderstanding (Alchian & Woodward, 1988).

The same logic holds when internal governance comes under the microscope. Weber (1947) modeled rational/legal versus traditional organization as archetypes—abstractions meant to highlight and define constructs; real organizations would most likely contain a mixture of rational/legal and traditional elements. Barnard (1938) viewed such a mixture as not only likely but necessary; the existence of informal relationships and authority structures allows the more rigid formal organization to respond in a timely manner to environmental shocks and provide members with personal meaning through cooperation.

The strategy literature cited above incorporates this logic. Scholars working in the "relational view" (J. H. Dyer & Singh, 1998), the "resource-based view" (Barney, 1991), or the "institutional view" (Peng, 2003) all call for more

Table 2 The Formal and Informal Economies

Dimension/Element	Representative Scholarship	Formal Economy	Informal Economy
External compliance			
Legal registration of business	W. G. Dyer and Mortensen (2005)	Yes	No
Legality of product	London and Hart (2004)	Yes	Yes
Legality of process	ILO (2002)	Yes	No
Compliance	Chakraborty (1997)	Substantial	Partial or none
Legitimacy	Webb et al. (2009), Meagher (1990)	Broad social base	Narrow social subgroups
Formal institutional protection	Castells and Portes (1989), Hudson and Wehrell (2005)	Yes	No
Property rights	deSoto (2000), Marcouiller and Young (1995)	Vested in law	Vested in custom
Internal governance			
Individual actors	Boisot and Child (1996), Li et al. (2009)	Atomized	Socially embedded
Transaction base	Gaughan and Ferman (1987), Li et al. (2009)	Arm's length/contractual	Relational
Reciprocity	Gaughan and Ferman (1987), Henry (1987)	Balanced	Generalized
Organization structure	Hart (1973), Boisot and Child (1996)	Bureaucratic	Non-bureaucratic
Other characteristics			
Capital intensity	Henry (1987)	High/moderate	Low
Scale	Thomas and Mueller (2000)	Large	Small
Human capital	LaPorta and Schleifer (2008)	High	Low
Examples		"American" style firms	Family shops, street vendors

informal internal governance as a logical way to create and sustain competitive advantages. Significantly, none of these scholars advocates abandoning the firm's legal status or formal institutional participation. While extant thinking, based on Weber's own logic, tends to see rationality and tradition as substitute forms of organization, Poppo and Zenger (2004) find the two elements to work in complementary fashion.

This argument, illustrated clearly in Table 2, leads to the conclusion that when the focus shifts from a "sector" or "economy" to the elements and activities actors engage in, a picture of economic activity emerges that reveals a variety of different options from wholly traditional and outside the law to wholly rational and operating in complete compliance, and every point in between. Thus what has been modeled as a world of discrete entities is actually a world of continuous variation (Chen, 2006; Zinnes, 2009), and management scholars have much to gain by working through the difficulties involved in such nuanced theory building in order to gain a greater degree of understanding for the phenomenon of interest.

Table 2, based on a close reading of various perspectives on the informal economy, helps answer these questions as one adopts the perspective of informal elements as opposed to an informal economy. Given a variety of organizing recipes, rational choice theory suggests that actors will chose those arrangements with the highest perceived utility, irrespective of property-rights protections, scalability, or a bureaucratic internal structure. When informal elements carry efficiency properties rational actors will choose informal structures, as Abigail does or as Don Anderson did. Simi's case, however, suggests that factors other than rational choice, defined in terms of economic efficiency, may come to bear on the decision to operate informally (Zinnes, 2009).

Informal Arrangements and External Compliance

Why should rational and often highly ethical economic actors choose to forego the institutional protections and benefits concomitant with the legal standing and status that both registration and compliance bestow? DeSoto (2000) clarifies the costs of noncompliance: enterprises cannot grow, as greater size attracts the attention of police, tax collectors, or other regulators, so non-registered (or noncomplaint) firms forego the advantages of scale economies. Such firms also run the risk of closure or the seizure of goods by the authorities. W. G. Dyer and Mortensen (2005) find that competing informally requires a number of workarounds, including a separate set of accounting records, as a consequence of competing informally. In spite of these disadvantages, the rational economic choice to forego external compliance makes sense under two conditions: the case of fragile or insecure institutions typically found in the developing world and the case of regulatory changes.

Insecure institutions. North (1990), for example, argues that poor countries are poor because they have "weak" institutions. The modifier "weak" belongs within quotation marks to highlight the highly normative assessment that usually follows the moniker "weak institutions." In this context, weak institutions *usually* mean institutions that do not look like nor operate in ways that promote American-style capitalism. The weak institutions of many developing world countries in fact prove to be remarkably durable and effective in regulating those living under their control. The title *insecure institutions* avoids such normative connotations and denotes institutional environments where the probability that institutional actors will implement or enforce explicit and formal mission and mandates lies significantly below 1 (*impotent* institutions), when implementation occurs based on arbitrary and capricious decisions of institutional actors (*immoral* institutions), or when implementation differs in systematically regular ways from the explicit and formal mission and mandate of the institution, those that discriminate against particular groups of actors (*intolerant* institutions). Scott's (2008) notion of institutions as cognitive, normative, and regulatory structures supplies a broader and richer model of the institutional environment than economic institutionalism, and his broader conception of institutions helps scholars see and understand how impotent regulatory institutions, for example, may be supported by immoral normative institutions and intolerant cognitive frames.

In many developing countries, the collection of taxes may be sporadic due to manpower shortages, with lower tax revenues leading to reduced services or benefits for those actually paying taxes (McMillan, 2002; Zinnes, 2009). If impotent institutions pose little risk of detection or provide few benefits of compliance, why bother participating? When governments at any level prove unable to hold up their end of this social contract (taxes in exchange for services), then noncompliance may have less to do with criminal evasion than clever calculus: why pay something when nothing will be returned? Impotent institutional leaders may tacitly or openly encourage informal activity because the lack of tax revenue eliminates the need for those leaders to develop the infrastructure and capabilities to deliver services internally rather than relying on mechanisms such as foreign aid (Easterly, 2006).

DeSoto (2000) believes that registration provides relief against immoral (corrupt) institutions; clearly, the lack of a business license or other official documentation exposes individuals to corrupt police or regulators. Registration may, however, bring the organization to the attention of the same immoral institutional actors who can then extort bribes or other payments (DeSoto, 2000; Dyer & Mortensen, 2005; Johnson, Kaufmann, & Zoido-Lobaton, 1998). Registration may mean trading informal confiscation through extortion for formal confiscation through taxation; the principle of marginal analysis implies that decision makers will choose the regime with lower confiscation costs and risks. When institutional participation results in arbitrary or capricious institutional extortion, participation may be more costly than noncompliance.

Finally, institutional participation via legal registration and compliance may be impossible for some groups because they belong to selected social or ethnic groups. While an uncomfortable realization, racism, sexism, ethnic hatred, and systematic discrimination are both de facto and often de jure in many countries around the world (Meagher, 1990, provides an account of how ethnic divisions translate into economic divisions in northern Uganda, and Mortenson & Relin, 2006, describe how divisions between Sunni and Shia Muslims translate into trading networks). Rules requiring documentation of citizens or foreign nationals or other restrictive visa rules may all work to create an overarching framework where certain groups face systematic exclusion from the formal economy, the result being a thriving informal economy populated by otherwise oppressed classes and groups (Portes & Sensenbrenner, 1993).

Regulatory changes. Regulatory regimes, particularly changes or the adoption of new enforcement or new mandates, influence participation in the informal economy (Besley & Burgess, 2004; Zinnes, 2009). Restrictive labor laws, particularly ones that raise the cost of hiring or dismissing workers, encourage Abigail's use of informal or unofficial labor. Small firms and those in labor-intensive or service-based industries seem more prone to move between formal and informal arrangements based on regulations and regulatory changes; it seems unlikely that large firms with capital-intensive balance sheets, given both their visibility and sunk costs, would be able to shift substantial amounts of activity to informal organization. Chen (2006), however, notes an increase in subcontracting by large firms may be an "informalizing" response to regulatory changes. For example, in light of changes to employment regulations or payroll taxes, building contractors (a trade I became familiar with as a graduate student) stop doing business through formal contracts but do their work "under the table." Clearly, however, the principles of rational choice suggest that the costs of external compliance will factor into the decision of whether or not to comply. The effect of regulatory changes would most likely motivate informal organization in both the developing and developed world.

Informal Arrangements and Internal Governance

That rational economic actors would willingly forego property-rights protections seems difficult to believe, especially for scholars trained in the paradigm of *Homo Economicus* and rational economic decision making. That rational actors would forego the advantages of rational internal governance and bureaucratic forms of organizations carries little surprise, however. Anyone who works in bureaucratic organizations, which almost exhaustively describes the set of readers of this article, knows of the myriad inefficiencies and hassles of working in highly formalized structures and how these often obscure the advantages of rational organization. Ouchi (1982) outlined in his *Theory Z* the advantages of traditional governance, and many of those advantages lead rational actors to organize informally. Traditional governance offers organizations cost savings in terms of both money and time. More importantly, however, traditional methods of control leave room for flexible adaptation and adjustment to uncertain internal and external environments.

Cost savings. Bureaucracy proves to be an expensive form of internal organization. Control comes by rule (Weber, 1947), but rules require human monitors and enforcers. Specialized and limited job descriptions, while promoting efficiency at task levels, require coordinators and planners to effectively harness the power of the division of labor. Finally, narrow job descriptions and meritocracy promote specialization, but change and obsolescence require retraining and further education. Traditional organization, with control and coordination arising from social mechanisms such as clan or tribal norms and values replace the need for salaried controllers and coordinators (Bosoit & Child, 1996), as well as providing lower cost access to critical resources (Acquaah, 2007). The lack of specialization and narrow job descriptions often found in a traditionally organized firm trades the efficiencies of specialization for the efficiencies of cross-training and flexibility in work assignments. Informal communication facilitates rapid ad hoc problem solving and adjustment that saves time, perhaps the most costly resource for an organization.

Costs savings also come in the enforcement mechanisms accompanying informal arrangements; indeed, Bolton and Dewatripont (2005) refer to informal, or relational, contracting as a set of self-enforcing agreements. Others classify these as private ordering arrangements (J. H. Dyer & Singh, 1998). Self-enforcing agreements cut costs in two ways. First, because they are self-enforcing, neither party pays third parties to either represent them or adjudicate the agreement. Second, and far more important, self-enforcing agreements can, for better or worse, be quickly resolved, thus reducing the overall opportunity costs of disputes and disagreements. Compare the rapid resolution of a privately ordered arrangement with the two-decade-plus delay in the case of the Argentine squatters cited above.

Adaptiveness and flexibility. Informal communication networks, flexible work assignments, and values-based decision criteria endow informal organizations with greater adaptiveness and flexibility, which becomes particularly important when organizations face uncertain and turbulent environments. Bennett (1958) details the efficiency of informal economic arrangements in the Japanese forestry industry just after World War II. The Japanese government permitted, and looked favorably upon, family-based informal systems of timber collection because such a method of organization met official goals of promoting maximal employment with minimal government involvement and the related costs. Japanese timber bosses, operating without bureaucratic oversight or control, and having strong tradition-based authority in the communities they ran proved able to allocate resources more effectively, more quickly, and more cheaply than government ministries.

More recently, Spicer et al. (2000, p. 639) showed how in post-communist Eastern Europe (Hungary, Poland, and the Czech Republic) informal networks of local business people and political actors "emerged to help managers and work teams, suppliers and customers, firms, and local party members coordinate continual adaptation to the shortage environment" caused by the transition from communist to capitalist meta-institutions (Friedland & Alford, 1991). In this case, rational organizations proved less adaptive and competent in attending and responding to severe environmental uncertainty; traditional relationships and informal norms offered actors a superior form of organization.

Highly uncertain task environments, such as those facing entrepreneurial firms, also favor informal, traditional governance. Saxenian (2000) argues that a hallmark of successful Silicon Valley start-ups is their ability to use informal contracting and social network ties throughout the value chain in order to resolve uncertainty surrounding new products and emerging markets. At the earliest stages of business formation—entrepreneurship before a business has formed—uncertainty surrounding the ability, integrity, and overall value of business partners, suppliers, customers, and investors invites entrepreneurs to build networks based on family or friendship ties. If one doesn't have the time to vet potential partners, then dealing with friends or known associates becomes a rational strategy. Similarly, lacking resources and track records, new businesses seek customers and suppliers by tapping friendship networks, and family and friends become the initial investors.

Hyperrationality. Informal arrangements make sense in advanced economies when too much rationality and compliance become dysfunctional and organizations become hyperrational (Turner, 2004). Henry (1987) observed more than two decades ago that the informal economy—long an artifact of the poor, developing world—continued to be more prevalent and important in the advanced economies. Since the late 1980s, macro-organizational scholars have also shown an increased interest in informal methods of organizing, such as culture (Barney, 1986), trust (Barney & Hansen, 1994; Hosmer, 1994), relational governance (J. H. Dyer & Singh, 1998; Poppo & Zenger, 2004), and stakeholder theory with its focus on iterative, relationship-based management (Freeman, 1984; Freeman, Harrison, & Wicks, 2008).

Turner (2004) offers one plausible explanation of this coincidental movement: informal organization becomes a powerful response to hyperrational organizations and environments. The informal economy holds the key that allows escape from the "iron cage" of capitalism (Weber, 1958). Hyperrationality, Turner (2004, p. 207) explains, occurs when

> Rational calculation of costs and benefits comes to dominate a society as profit-oriented markets extend to virtually all spheres of life. Increased levels of impersonality, formality, technical specialization, and cost calculations all become essential features of social relations as bureaucratization prevails in economic and other arenas of social organization. As these processes continue, they generate a hyperrationality—a concern with efficiency, speed, and profit—that, ironically, can generate less efficiency, speed, and profit. For example, "fast food" restaurants are often not very fast because they attract too many customers at peak times and force them to line up and wait.

The response to hyperrationality entails a movement to informality. Again, Turner (2004, p. 207) notes:

> Because economic activities can often be performed more efficiently and cheaply outside a corporate structure, subcontracting to small-scale specialists increases, creating cadres of self-employed providers of services (from computer consulting, engineering, payroll, and finance to maintenance and transportation) that are less bureaucratically organized, especially if they remain small ... revolving around teamwork, flexibility, reduced authority, temporary employment.

Hyperrationality begets informality. The symbiotic relationship between formal and informal arrangements acts as a type of social and economic safety valve, with each preventing the other from becoming a dangerous hypertrophy of itself; when formality ceases to be effective and efficient, actors naturally move toward informality, and vice versa.

This section establishes the basis for a model, rather than a definition, of the informal economy that follows. As this section illustrates, informal economic activity penetrates deeply into several activities of interest to management scholars—from the earliest stages of entrepreneurial development to the largest, most hyperrational bureaucracies. In what follows, I provide the outlines of a model of informal activity that avoids the narrow constraints and contradictions of a simple definition and captures some of the rich diversity of economic activities that take place informally. I intend to replace a more simple view of the world with a more complex one (Davis, 1971) but hope to balance an increase in analytical precision gained by complexity with a need for theoretical generality (Weick, 1979).

A Model of Informal Economic Activity

I begin by building the classic 2 × 2 matrix based on the dimensions of external compliance, with engagement in illicit or licit practices/exchanges serving as the defining poles, and an internal governance dimension, anchored by bureaucratic versus non-bureaucratic governance. The prima facie logic suggests that bureaucratic internal governance presumes external compliance as ultimate enforcement of bureaucratic standards relies on third -party enforcement, which in turn relies on legal or other formal regulatory mechanisms.

This prima facie assumption may prove false, however. Substantial evidence and logical arguments suggest that entities competing informally (illicit means or ends) may organize along bureaucratic lines, complete with third-party enforcement. First, organizations may compete in some licit and some illicit activities, implying that their licit activities may be bureaucratically structured and subject to legal regulations and protections. Consider Napster, the exemplar of Webb et al.'s (2009) portrayal of the informal economy. While Napster pursued illicit ends (illegal transfers of copyrighted material), it did so as a legally registered corporation capable of being sued (e.g., A&M Records, Inc. *v.* Napster, 2001). Similarly, one can reflect on the number of building contractors utilizing the illegal practice of undocumented workers who operate as licensed contractors and withhold payroll and income taxes from those same workers (Sassen-Koob, 1989; Webb et al., 2009).

The paradox of formal/bureaucratic/legal protection and governance for illegal economic activity arises from at least three sources. First, most constitutional states offer residents some blanket protections to citizens. Freedoms such as expression or the right to collective organization may supersede regional or local regulations. Ventakesh (2006) describes an underground economy in Chicago's urban South Side that opportunistically invoked their right to police protection and public safety to intervene in community affairs while simultaneously putting at risk their off-the-books businesses. Similarly, a country's meta-institutional orientation (Friedland & Alford, 1991) may create classes such as labor, capital, or ethnicity (e.g., such as indigenous peoples) that grant special rights to all members of the protected class.

Second, the formal institutions of the state exist as separable organs; each one will focus on their own work and interests and have only limited contact or overlap with other bureaucratic organs. Weber (1947) outlines the division of labor and clear lines of reporting and authority that characterize efficient professional bureaucracies. Tax collection falls under one department, employment regulation a second, and workplace safety a third. Each agency, tasked with its own mission, authority, and objectives, often finds little reason, and even less incentive, to notice and report activities outside their official scope. Entrepreneurs seeking advantage from one branch of the state need only insure that they meet the requirements of that state; for example, the United States IRS cares whether employers withhold taxes from employees, whether those employees have the proper documentation or not. Bureaucratic separability may be particularly characteristic of the impoverished nations filled with poor, subsistence entrepreneurs (Easterly, 2006), and government officials working in their own silos may afford protection to enterprises duly registered, even as those entities violate other laws.

Finally, the advantage provided by formal organization and legal standing help informal economy participants create and maintain order in their world. Specifically, formal organization and legal registration encodes certain baseline rules of behavior or procedures such as compliance with basic health practices or standards. Formal organizations make plain the social contract that often underlies informal activities (Durkheim, 1933/1984). Bureaucratic governance also provides for a legitimated authority structure with roles, hierarchies, and procedures to enforce rules and contracts. Such a structure provides informal entrepreneurs with legitimacy when they must violate unspoken social norms. Put differently, formal structures and legal backing provides informal entrepreneurs with a set of mechanisms that reduce the risk of transacting business—both risks from state intrusion but also market imperfections or vagaries.

Figure 1 presents a model of economic activity. The diagonal quadrants (I and III) account for the types of organizations most prevalent in the literature; organizations in the formal economy have been well studied in management, and informal firms have received attention in economics, policy studies, and sociology (see Guha-Khansnobis et al., 2006; Portes & Sensenbrenner, 1993; Venkatesh, 2006, for examples of research around quadrant III economic activity). Quadrant IV—the semi-formal relational economy—has received substantial attention by scholars working to understand trust, relational, and transactional governance (e.g., Barney & Hansen, 1994; J. H. Dyer & Singh, 1998; Lazzarini et al., 2004; Poppo & Zenger, 2004). These researchers find that informally governed transactions, operating within legal activities and processes, provide firms with substantial advantages in times of uncertainty and change. Serious study by management scholars of quadrant II—the structural informal economy—remains to be done, and quadrant II may represent the quantum leap for management scholars.

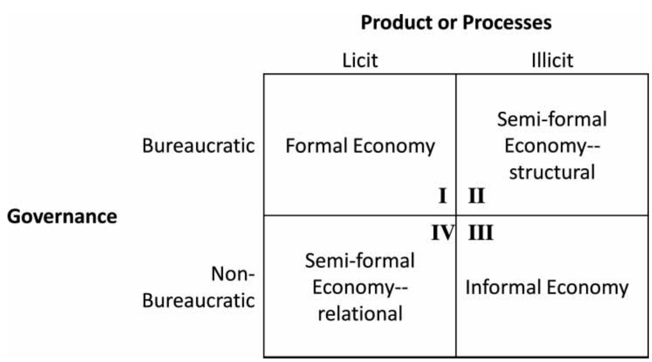

Figure 1 A New Model of the Informal Economy.

First, semi-formal structural firms should exist in both the developed and developing world. I noted above that the traditional description of developing country institutions as "weak" belies the strength of these institutions. I might add a fourth "I" to the above-mentioned list: incomplete institutions. Godfrey and Dyer (2011) describe the institutional situation in Ghana, where informal entrepreneurs have institutionally sanctioned access to some formal institutions such as state-sanctioned labor/industry associations but not others, namely formal property protections. In developed countries, the existence of quadrant II firms presents interesting opportunities to strategy scholars—how do such firms gain competitive advantages?—and to ethics scholars who may investigate how such firms create internal ethical norms to govern conduct.

The four quadrants outlined in the model provide a launch point for serious investigation of the informal economy by management scholars; the boundaries created by the quadrants lend themselves to generating testable hypotheses and areas for theoretical development. Rather than spend time detailing the characteristics of each quadrant, I now move to outlining a potential research agenda for the informal economy, based on the model in Figure 1. The goal of the Annals is to spur research and open frontiers. Thus I'll leave it for another paper or another author to flesh out the characteristics of firms in the different quadrants.

A Research Agenda

The informal economy is huge, in terms of both its practical impact on economic activity and the intellectual disciplines that touch on this form of production and exchange. The model presented in Figure 1 establishes a roadmap for navigating this vast terrain. Setting a research agenda for management seems a daunting task: so many potential avenues for fruitful research exist that the notion of an agenda necessarily excludes as much as it includes. I return to the four case studies that opened the paper to frame four key questions that constitute the hills just ahead toward the frontier of the informal economy.

Francis's Question: Quadrant III and Whither the Poor?

Francis reminds researchers of the scale of informal economic activity and the raw numbers of individuals whose livelihood depends on this type of value creation. Francis encourages scholars to ask whither the poor, or how can management scholarship make a positive difference at the bottom of the economic pyramid? Early research in international business mapped the terrain of the developing world more than 25 years ago (Paul & Barbato, 1985). However, the work of C. K. Prahalad and Stuart Hart, together

(Prahalad & Hart, 2002) and individually (S. L. Hart, 2005; Prahalad, 2005) on the BOP, as well as London and Hart's (2004) research on doing business at the BOP, began a new phase of interest in management scholarship aimed at alleviating poverty.

What may be referred to as BOP 1.0 began with a natural perspective of multinational corporations and how they could become involved in poverty alleviation. Prahalad's (2005) book bears a title that would foreshadow both criticism and evolution: *The Fortune at the Bottom of the Pyramid*. Karnani (2007a, 2007b, 2009) leveled two criticisms against BOP 1.0: a focus on the poor as consumers rather than producers (Karnani, 2007a, 2009) and a disregard for the negative social impacts of multinational products on the poor and the culture of developing nations (Karnani, 2007b).

Recently, London and Hart (2011, p. 3) seem to usher in BOP 2.0, which in their description represents "a second generation of approaches with a markedly different orientation and value proposition has emerged. Framed more accurately as business with four billion, this 'fortune creating' perspective emphasizes co-creating new business models, technology solutions, and value propositions with the BOP." As Viswinathan (2011) argues, a key element of BOP 2.0 consists in understanding poverty and informal economic activity from an emic, participant centered approach.[6] London (2009) makes an important call for holistic measurement and project assessment as a part of the broader BOP 2.0 agenda. Progress in this area seems to gaining traction; some reminders about the challenges faced by the dualists, structuralists, and legalists should benefit management scholars as they press ahead with a sharper focus and renewed energy.

The persistence, and spread, of the informal economy runs counter to the theoretical underpinnings of the dualist model: that the informal economy represents an inherently inefficient method of organizing production and exchange when compared to formal organization and institutions (Lewis, 1954/1958). Because of this, the informal economy should give way and eventually disappear at the advance of its more efficient counterpart. Much of the work in development economics over the last half century focused on aiding and abetting this transformation (Ray, 1998). Easterly (2006) outlines how poorly this agenda fared in practice; much of the failure lies in the fact that the assumptions of the dualistic model don't conform to reality. Informal enterprises, and laborers, have marginal productivity greater than zero, and informality proves a robust organizing model across a number of institutional contexts (Henry, 1987; North, 1990). The goal of dualism—industrialization and adoption of Western-style capitalist practices (Baumol, Litan, & Schramm, 2007)—lacks philosophical and practical appeal in many societies around the globe.

The disappointing results from the dualist model invite management scholars to keep their assumptions and goals top of mind. What assumptions underlie management's (collective study of informality and poverty) approaches? Do we see the informal economy as an inefficient response and an historical anomaly or a vibrant expression of social, economic, and cultural strength in communities throughout the world (Geertz, 1963)? While the goal of management scholarship may be normative as well as positive, social change as much as theoretical understanding, how much do those goals rely on transforming informal street vendors and entrepreneurs such as Francis into Western-style capitalists? Concerns among BOP scholars for concepts such as scalability (models that tend to deny or downplay local embeddedness) may prove to be a slippery slope in encouraging enterprises that meet the goals of developed country scholars, donors, and policy makers but not the goals of participant entrepreneurs.

Part of the frustration of the dualist agenda, I believe, comes from faulty assumptions and misguided goals: that many in developing nations wanted to and could easily be molded into Western-style capitalists. Management scholars would be wise to make explicit both the starting assumptions and end goals of their inquiries and pursue a more limited, positively focused research agenda. Adopting key lessons from the structuralist strain of informal economy research may help scholars avoid some of dualisms minefields.

Structuralists (e.g., Venkatesh, 2006) see the informal economy as a conundrum—a fact of life for people shut out from the formal institutional infrastructure of the society's in which they live, but also a vibrant and flexible form of meeting people's economic needs and providing social meaning and purpose in their lives. The challenge this work highlights is one of balance. LaPorta and Schleifer (2008) impugn the romantic view that informal entrepreneurs are clever, creative, and capable of running any type of business; they then proceed to (almost) equally romanticize the superiority of the formal economy and well-trained managers. As research and theorizing continues, management scholars would do well to remember one of structuralisms key findings: informal economic activity is both creative and coercive, opportunity rich and oppressively poor. Informal economic activity may help lift people out of poverty or trap them into it. The field, as well as real progress in mitigating the devastating effects of poverty around the globe, will be well served when scholars look for both the positive and negative aspects of informal economic activity in their research.

The lesson from legalism resonates with one of my own frustrations in dealing with colleagues who want to maintain simplistic views of the informal economy; these colleagues argue during presentation and in feedback that the informal economy, and attendant poverty, results from "weak institutions." These colleagues often invoke a reading of North (1990) that implies that poverty results from weak institutions, the natural consequence of which is that if these countries would strengthen their institutions—primarily the rule of law and related financial markets and institutions—poverty would disappear. The very visible hand of market imperfections can be called upon to locate the causes of underdevelopment, and if only the invisible hand could carry the day, the problems of poverty and underdevelopment would cease to be. A second implication indicates that study of "weak" institutional environments thus has little to do with mainstream management theory; working to help the poor exists as a sort of intellectual sideshow.

While I don't deny the role of institutional reform in alleviating poverty, the easily invoked (but fundamentally incorrect) notion of weak institutions provides an overly simplistic solution to a complex problem. In reality, the institutions supporting and sustaining poverty prove remarkably robust, strong, and able to resist change and reform (Thelen, 1999). A rich understanding of the informal economy and how it can be used to create pathways out of poverty necessarily involves more than simplistic explanations such as "weak institutions." The presence and growth of informal economic arrangements within the developed work belie the "weak institutions" story; the causes and consequences of the informal economy stem from many factors across many levels, and these types of problems seem especially amenable to study by management scholars. One unique competitive advantage of management scholarship comes from the existence of multiple paradigms and levels of analysis at work in the field and a number of scholars willing to view the problem from a number of different theoretical lenses and across levels of analysis.

Abigail's Question: Quadrant II and When Is a Firm (In)Formal?

Abigail's case highlights the issue of the scope of organizational forms that constitute the informal economy and suggests the question: when should we consider a firm (in)formal? Her case goes to the heart of current theorizing about informal activity, the intellectual legacy of the dual economy, structuralist, or legalist models. Abigail's case suggests that the formal–informal distinction obscures as much as it reveals and that scholars should think in terms of degrees of formality or informality. The revised model, outlined above opens an intellectual space for enterprises such as Abigail's, who clearly competes in quadrant II.

One major challenge of a complex theory, as opposed to one composed of dichotomous categories, lies in the change of focus from what differentiates the objects of study in the former to what is similar in the latter. With only two categories to choose from—formal or informal—categorizing firms becomes a simpler task: a firm is either formal (figure) or informal (ground). Expanding the definition to include more discrete forms may enhance our collective ability to accurately, rather than just simply, categorize firms and actors. However, two challenges appear when the figure–ground architecture of the formal–informal economy dichotomy becomes a collage of formally and informally textured activity. Scholars must find workable definitions to avoid the loss of generality to avoid subdividing the gradations of the informal economy into a continuum of unique forms (Zinnes, 2009). The goal should be to find a new balance between Weick's notions of Generality, Accuracy, and Simplicity. Second, theorists and researchers must discern and identify which formal–informal combinations of various attributes work together to create coherent and viable organizational forms. For example, what types of organizational forms populate quadrant II?

Complex theories challenge scholars because demarcations between theoretical poles become less well defined, and the focus shifts to the open space between the two anchors. If states A and B exist as archetypes (Weber, 1947), then the limits of theory and research come, as we may only say that a set of real organizations is closer to A than B or vice versa. In the present case, how many informal elements must be identified for the firm to be classified as informal, semi-formal, or formal? Take legal compliance for example. While the notion of illegal product and service appears clear, think of Napster, which operated in a legal grey zone by attempting to stake out a new position around an unclarified legal concept—due to technological change (Webb et al., 2009). Only *after* Napster began operation and was sued did the grey zone turn to black, as case law moved to clarify and define a new technological horizon.

Napster's business model appears hauntingly similar to accounting firms that promote new and exotic tax shelters, ones often crafted upon hazy or incomplete rulings and exploiting the fuzzy spaces of previous rulings. If Napster is an informal firm, then how should we categorize the major accounting firms? There seems to be an intuitive difference, but naming and scoping that difference may prove difficult indeed. The upside of complex theory is that it provides a conceptual underpinning for "interstitial" activities such as Napster, tax shelters, or farmers' markets. The downside may come in the illusion of certainty, as it just pushes the definitional problem one step lower.

What makes the formal–informal categorization complex, and creates its own momentum toward a continuous one, is the number of subdimensions illustrated in Table 2. With 14 identified dimensions, and close to 100 potential combinations (there could be more, as Table 2 provides a summary not an exhaustive listing), the number of potential forms exceeds the ability of theorists to say parsimoniously much of anything about the formal or informal status of a firm. With at least two dimensions, each of those with relevant subscales, how do scholars weight and consider different configurations? The low hanging fruit suggested by the model presented in Figure 1 constitutes narrowing the potential list of logical possibilities to logical plausibilities and then logical probabilities to determine viable forms. A healthy dose of empirical testing follows such work to determine which configurations tend to be present and to what degree in different contexts, both in the developed and developing world.

Don Anderson's Question: Quadrant IV and What Happens Outside Organization?

Don's case invites scholars to see two important aspects of informal economic activity: that informal activity occurs in the developed world, as well as the developing one, and that the two systems exist in a value-adding symbiotic relationship. The natural question becomes: what happens outside formal organization? How can scholars best characterize the relationship and synergy between informal and formal economic activity, where the formal organization constitutes no more than a permeable membrane for exchange or necessary recognition from government authorities?

These questions bring to mind Barnard's (1938) observation about the relationship between formal and informal organizations. He notes, "informal association is rather obviously a condition which necessarily precedes formal organization. The possibility of accepting a common purpose, of communicating, and of attaining a state of mind under which there is a willingness to cooperate requires prior contact and preliminary interaction" (p. 116). Barnard's analysis focuses on the organizational and human advantages of informal organization; informality allows joint purposes and goals to coalesce slowly and facilitates the type of interpersonal understandings that build trust and mutual reliance (Mayer, Davis, & Schoorman, 1995). For Barnard (1938), to define the organization as the formal structure and relationships without the accompanying informal elements would be to fail to define the "organization."

Poppo and Zenger (2004) see informal (they use the term relational governance) and formal modes of governance as complements and present empirical evidence that back up their claims. By combining both rational and relational governance, actors can combine the best of both worlds: the stability and security of legal and institutional protections and the flexibility and speed of informally governed relationships. Don Anderson had just enough legal organization to make the business work; the rest of his business ran completely on a relational basis, far different from the complementarity Poppo and Zenger (2004) studied. Don's case raises several interesting issues.

One avenue for fruitful inquiry would consider not *if* informal and formal arrangements are substitutes or complements but *when* the two substitute for each other and when they act as complements, thus bringing the dynamic and symbiotic relationship between the two governance modes into sharp relief. Similarly, given Saxenian's (2000) analysis of the use of informal mechanisms in Silicon Valley startups researchers can plumb the depths of the minimal level of formality needed to allow non-bureaucratic governance to flourish. Such research should combine settings in the developed world, with secure institutional foundations, and the developing world, with their often insecure institutions, to compare and contrast how substitution and complementarity work around the world.

Simi's Question: Whose Values Create Value?

Finally, Simi's case raises the most difficult question of all—the morally laden question of the role of values and ethics in the selection of formal or informal arrangements. Whose values create value? Management scholars, owing to the strong influence of economics as a foundational social science discipline (Pfeffer, 1993), adopt as a "ground" for theory development the assumptions of a rational, maximizing *Homo Economicus* with an explicit *maximand* of utility measured by money. What about those who maximize something else, such as leisure time, aesthetic interest, or adherence to a moral or religious code? Such questions can be easily dismissed if the dominant role of traditional or religious values can be limited to indigenous peoples, which constitute a small part of the world's population.[7] The challenge becomes much broader, and the possibilities for scholarly inquiry richer, when one considers the many regions of the world where traditional, non-neoclassical utility (money) maximizing, values hold sway: many countries in the Middle East, Africa, and Asia. Consideration of the morality of strategy, not merely the strategy of morality, could greatly enlarge the field of vision for macro-organizational scholars.

The question of values should redirect strategy and macro-organizational research. What would strategic management scholars say to Simi? Certainly, her link to traditional harvesting and preparation methods for her herbs and medicines gives her a competitive advantage in product differentiation; however, she seems unwilling to exploit those advantages to earn superior returns. In fact, Simi feels that the source of her competitive advantage—a deep respect for the spiritual nature of the plants and roots she collects—lies precisely in her *unwillingness* to exploit the traditional methods that set her apart. What would competitive advantage mean for her? To the extent that Simi shares similar values with others in both the developed and developing worlds, then the question of values offers management scholars the opportunity to expand the domain and scope of their inquiries and to refine foundational notions and terms such as competitive advantage across moral contexts. Stakeholder theory, with its emphasis on values and ethical considerations, lays out a basic template for such inquiry (Freeman et al., 2008). This work suggests that scholars, as well as managers, should consider the value orientations and deep needs of various stakeholder groups, including those whose priorities do not conform to economic rationality, when considering how value is created; indeed, Simi's devotion to moral and religious values suggests a much broader definition for value creation.

The questions surrounding moral values circles the argument back to questions about the poor and the field's tacit orientation toward poverty reduction, the BOP, and economic development. I noted above that scholarly research to date exhibits patronizing tendencies, and my experience in working with

Navajos and others in the developing world leads me to believe that our tacit judgments about the moral values of those at the BOP encourage questionable policy recommendations. Harrison (2003) notes that no one advocates poverty over wealth, ignorance over knowledge, or sickness over health, but that we often forget that wealth, knowledge, and health mean different things to different groups. The problem comes when the tacit definitions of wealth (money income), knowledge (analytical, rational knowledge), and health (the absence of disease) of Western researchers obscure an equally valid view of wealth (psychic and aesthetic enjoyment), knowledge (experiential and emotional), and health (physical and spiritual flourishing) held by the subjects we study. Simi's case reminds scholars to tread carefully and consider the normative implications of the positive theories and models they develop.

Conclusion

The informal economy is huge. Informal economic arrangements represent a dominant form of exchange for many of the world's peoples and, depending on how one defines informality, may be the dominant model of economic organization. The informal economy offers management scholars the opportunity to investigate new contexts such as the BOP and look at existing contexts like entrepreneurship and early-stage enterprises in a new light. The study of the informal economy also provides scholars with a chance to develop constructs and dimensions fit for a complex, rather than discretely simple, conceptual world. Finally, the informal economy raises insightful questions about the interplay between moral and economic values in the decisions individuals make about how they structure their economic lives.

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Endnotes

1. Personal interview, 2005.
2. Personal interviews, 2005, 2008, and 2009.
3. Don passed away in 2002. The vignette reported here comes from my own observation plus conversations with family members.
4. Personal interview, 2010.

5. My definition of the criminal economy highlights the definitional quagmire surrounding the informal economy in general. Criminality, rather than illegality, becomes the operative standard. Geldart (1984) cited in Black's Law Dictionary (1999, p. 239) notes, "the difference between civil law . . . and criminal law turns on the different objects which the law seeks to pursue—redress or punishment. The object of civil law is the redress of wrongs by compelling compensation or restitution . . . On the other hand, in the case of crimes, the main object of the law is to punish the wrongdoer." I note that what constitutes criminal behavior varies by both geography (gambling becomes a criminal offense when one leaves the State of Nevada) and time (witness California's ongoing efforts to decriminalize or legalize marijuana). The line that differentiates the criminal from the merely informal appears quite thin and subject to shifts over time.
6. Viswinathan's work at the University of Illinois and the Center for Subsistence Marketplaces is exemplary. The Center sponsors a biennial conference that provides global scholars with a venue to share research from a variety of perspectives, including those living at the Bottom of the Pyramid. Also, at this writing two journals currently have special issue calls out for BOP and Emerging Markets research, the Journal of Business Venturing and the Strategic Entrepreneurship Journal.
7. The ILO estimates that in Latin America, for example, indigenous populations total just over 6% of the total. http://www.ilo.org/public/english/region/ampro/mdtsanjose/indigenous/cuadro.htm, accessed 19 October 2010.

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