

## Development Strategy on Business of Informal Sector and Its Role in Reducing Poverty in South Sulawesi, Indonesia

**Syamsu Alam**

*Faculty of Economics and Business, Hasanuddin University, Indonesia, Jln. Perintis Kemerdekaan KM. 10  
Tamalanrea, Makassar 90245; Email: salam.feunhas@gmail.com*

**Maat Pono**

*Faculty of Economics and Business, Hasanuddin University, Indonesia, Jln. Perintis Kemerdekaan KM. 10  
Tamalanrea, Makassar 90245; Email: maatpono.feunhas@gmail.com*

**Musran Munizu**

*Faculty of Economics and Business, Hasanuddin University, Indonesia, Jln. Perintis Kemerdekaan KM. 10  
Tamalanrea, Makassar 90245; Email: m3.feunhas@gmail.com*

Doi:10.5901/mjss.2016.v7n6p97

### Abstract

*The study is aimed to identify the problems of informal sector business, to design the models and strategy in developing informal sector business, and to analyze the role of informal sector in reducing poverty in South Sulawesi. The population of the study is the informal sector in Makassar, and Pare-Pare, South Sulawesi Province. The number of samples is 200 people. Purposive sampling is used as the sampling technique. Data is analyzed by descriptive statistics, and Analytical Hierarchy Processes (AHP). Then, data is processed by IBM SPSS 22 and Expert Choice. The results show that the main problems faced by the informal sector consist of: (1) the lack of government support, (2) access to capital is relatively difficult, (3) business management unprofessional, (4) lack of labor skills, (5) Lack of marketing network, (6) retribution, (7) the urban planning policy, (8) generally do not have a business license, (9) competition, and (10) the existence of illegal fees. There are three alternative strategies that can be used to develop the informal sector, namely: (1) empowerment, (2) formalization (legal / business licensing), and (3) the localization, which provides the location for the informal sector. Development of the informal sector requires the support and commitment from the stakeholders, especially local government. In addition, the support from the institutions such as universities, NGOs, and the private sector. The study also shows that the informal sector has a greater role as a source of people income. Furthermore, the informal sector also contributed as a provider of jobs, reduce poverty, and as a source of local revenue and economic growth.*

**Keywords:** *development strategy, problems of the informal sector, poverty reduction, business performance*

### 1. Introduction

Empirically, the significance of the informal sector in providing an opportunity to generate wealth for Indonesian citizens cannot be undervalued. The sector plays a big role in economic development through job creation, the supply of affordable goods and services and the reduction of poverty. It is estimated that about 65 percent of the Indonesians workforce is employed in the informal sector. The sector is characterized by underemployment, bad working conditions, uncertain work relationships and low wages. Most of them are in central of the city (BPS, 2014). In developing countries, about 30-70% of the population in the urban labor force works in the informal sector (Widodo, 2005). Thus, in Asia self-employment covers around 60 percent of the total informal sector (Becker, 2004)

Since the financial crisis in 1998, the informal sector is one of the most important activities that characterizes the urban environment. National Development Planning Agency of Indonesia (BAPPENAS) noted that the informal sector plays quite important in the development of society and national development. Informal sector employment has become the third alternative development programs that are less able to provide job opportunities in the formal sector (Dimas, 2008).

On the other hand, the informal sector is the basis of community economy that has been tested and will not be shaken by the economic crisis (Brata, 2010). The informal sector became one of the important activities that forming the

element of city. The location of many informal sectors occupy a strategic place as regional trade, residential, offices, industrial estates to public facilities (Setiawati *et al.*, 2000; Yatmo, 2009). According to Haris (2011) the inability of the formal sector to absorb labor force resulted in the majority of the workforce, especially Reviews those who are looking for work, are required to meet the economic needs through the informal economy. The existence of the informal sector is seen as a challenge. Informal sector workers as well as workers and they also act as an entrepreneur.

This view of the informal sector which is incorporated into the structure of employment in urban areas in the third world countries, starting from the idea of Keith Hart. Since the informal sector concept was first introduced in 1973, has done a lot of research and policy began to highlight the employment opportunities of the poor in the city. Those involved in this sector are generally poor, low-educated, most-skilled and migrants, it is clear that they are not capitalists looking for profitable investment and also not as well known businessmen in general (Setiawati *et al.*, 2000).

The activities of the informal sector is very diverse as mentioned by Hart (1973), namely: (1) the activities of primary and secondary such as agriculture, plantation market-oriented, building contractors, and others, (2) businesses tertiary capital relatively large as the business of housing, transport, efforts for the benefit of the public, and others, (3) distribution in small street traders, market traders, grocer, hawkers, etc., (4) private transaction, for example, borrowing, begging, and (5) other services, such as street singers, shoeshine, barbers, garbage collectors, and others. Furthermore, Hart presented the findings based on two typologies of income earning opportunities in the city, namely: (1) The informal sector are legitimate, such as: agriculture, farming, tailoring, and so on. (2) The informal sector is not valid as a receiver of stolen goods, prostitution, pimps and others.

Previous research on informal sector businesses has been found in the literature. Alam (2004) found, simultaneously independent variables that consist the financial aspects, the environmental aspects, marketing, human resources aspects, and aspects of entrepreneurship have positive and significant impact on performance. The amount of independent variables on the dependent variable based on the rank of the greatest to the least in a row is an aspect of entrepreneurship, marketing aspects, financial aspects, environmental aspects, and aspects of human resources. The entrepreneurial aspect have dominant influence on the informal sector performance in South Sulawesi. The informal sector has important role in developing countries, including Indonesia. Generally, informal sector is unorganized sector, unregulated, and most legal but unregistered. Brotsunaryo *et al.* (2013) found that the informal sector planning as part of Semarang city planning is very important. There is a harmonious relationship between the merchant vendors and citizens of Semarang especially in fulfilling daily needs and should be accommodated in the spatial planning of Semarang.

Some factors can improve the growth of the informal sector is the limited opportunities of formal employment and termination of employment, the concentration of centers of economic activity, which eventually led to strategic places which become potential lands informal sector, and the movement of people from rural to urban areas (Yatmo, 2009). Based on the results of previous studies, this research goal is to identify the actual problems faced by the informal sector and determine the business development strategy of the informal sector in South Sulawesi, Indonesia.

## 2. Literature Review

### 2.1 The concept of Informal Sector

The concept of the informal sector introduced by Keith Hart, an economist from the UK, who conducts research on economic activities in urban areas of Ghana (Widyaningrum, 2009). ILO (1972) defines the informal sector as a sector that is not structured that appears in the center of town as a result of the inability of the modern sector to absorb new job seekers. According to Walther (2011), the informal sector is a sector that is doing the business of production without having any administrative business or formal permission. Furthermore, Kent and Mushi (1995), interpreted informal sector as individuals or groups of people engaged in legitimate enterprises either subsistence or small-scale, some of whom may be regulated by the state but the vast majority are considered to be operating outside the legal regulations of the state.

McLaughlin stated the informal sector consists of small-scale, self-employed activities (with or without hired workers), typically at a low level of organization and technology with the primary objective of generating employment and incomes. Thus, informal sector development is a fundamental strategy for reducing poverty as it promotes and empowers even the poor, women and the differently abled so that they can escape malnutrition, hunger, and diseases by working in this industry (Demba, 1999)

## 2.2 Characteristics of Informal Sector

ILO (1972) stated the characteristics of informal sector are low entry costs, and general ease of entry, unregulated and competitive markets, reliance on indigenous resources, family ownership of enterprises, small scale of operation, labour intensive and simple technology and lastly skills acquired outside formal schooling system. The informal sector in urban areas appear as a result of the imbalance in the labor market. Total labor force continues to grow as a result of urbanization and the inability to meet the demands of formal-sector jobs that require candidates for employment have educational qualifications and skills. Finally, push labor force should go into the informal sector to be able to continue to survive in urban areas. In this condition, the informal sector has a strategic role as an alternative effort to reduce unemployment and promote economic growth in urban areas.

## 2.3 Informal Sector Development Challenges

The informal sector activities are usually conducted underground or without following the laid down procedures in the formal spheres. Furthermore, informal sector lack specific policy which guides the sector. In addition, people engaged in informal sector lack capital, experience harassment by the LGA officials, lack business skills and have limited access to loan facilities (Muhanga and Nombo, 2010). Location of informal sector is very important to the development and sustainability of street traders, which in turn will affect the volume of sales and profit levels. In general, the difficulties faced by street traders ranging from government regulation of merchant locations structuring inadequate, lack of capital, lack of marketing facilities, and the lack of sufficient credit support from financial institutions and government (Hidayat,1978; Suharto, 2002).

In relation with the development of the informal sector, Haris (2011) asserts that the barrier development of the informal sector is divided into two terms i.e. the internal barriers include businesses is unorganized, less of working capital, and lack of health insurance. Then, external barriers include government policies are not aligned on the informal sector, and the difficulty of access to the market.

## 3. Research Methodology

This study was conducted using the quantitative approach. Secondary and primary data collection is conducted through survey of the objects of economic / informal sector actors that concerned and relevant to study. In addition, in this study will also be carried out activities focus group discussion (FGD) and in-depth interviews with entrepreneurs are willing to voluntarily elected interviewed, and other stakeholders to sharpen the analysis of the study. The number of informants were involved in focus group of 15 people. The location of this study conducted in the city of Makassar, and the City of Pare-Pare, South Sulawesi. The unit of analysis is the study of informal sector entrepreneurs.

Sample was taken by using purposive sampling, where the number of samples to be adapted to the purpose of the study (Hair *et al.*, 2011). Total sample set of 200 businessmen / entrepreneurs as respondents. The analytical method used in this study includes analysis Descriptive Statistics and Analytical Hierarchy Process (AHP) (Mulyono, 2002). Processing data using IBM SPSS software, and Expert Choice.

## 4. Results and Discussion

### 4.1 Testing of Instrument

In order questionnaire instrument which is used in this study have high degree of precision. Then, instrument has to test its validity and reliability. An indicator could be valid if it has value of  $r > 0.30$  (Hair *et al.*, 2011). While a variable could be reliable if the variable has value of Alpha Cronbach greater than 0.60. An instrument must meet the criteria of valid and must also be reliable. The results of testing the validity and reliability of the instrument were presented in the following table.

**Table 1.** Results of test the validity and reliability of instrument

Variable / Indicators	Correlation coefficient (r)	Alpha Cronbach (α)	Explanation
Business conditions (X)		0.820	Reliable
X <sub>1</sub>	0.687		Valid

X <sub>2</sub>	0.746		Valid
X <sub>3</sub>	0.616		Valid
X <sub>4</sub>	0.328		Valid
X <sub>5</sub>	0.644		Valid
X <sub>6</sub>	0.530		Valid
X <sub>7</sub>	0.679		Valid
X <sub>8</sub>	0.350		Valid
Developing of informal sector business (Y)			0.848
Y <sub>1</sub>	0.546	Valid	
Y <sub>2</sub>	0.368	Valid	
Y <sub>3</sub>	0.363	Valid	
Y <sub>4</sub>	0.535	Valid	
Y <sub>5</sub>	0.544	Valid	
Y <sub>6</sub>	0.609	Valid	
Y <sub>7</sub>	0.548	Valid	
Y <sub>8</sub>	0.567	Valid	
Y <sub>9</sub>	0.577	Valid	
Y <sub>10</sub>	0.562	Valid	
Y <sub>11</sub>	0.600	Valid	
Y <sub>12</sub>	0.462	Valid	
Y <sub>13</sub>	0.556	Valid	
Y <sub>14</sub>	0.517	Valid	
Y <sub>15</sub>	0.465	Valid	
Y <sub>16</sub>	0.585	Valid	
Y <sub>17</sub>	0.393	Valid	
Y <sub>18</sub>	0.431	Valid	
Y <sub>19</sub>	0.513	Valid	

**Source:** data processed, 2015

According to the table, it can be inferred that (1) the value of correlation on all indicators of greater than 0.30 ( $r > 0.30$ ), so it could be concluded that the indicators are used to measure the variables in this study are valid, (2) Instruments is used in data collection have high level of reliability. It can be seen from the value of Cronbach's Alpha ( $\alpha$ ) on each variable is greater than the standard value ( $\alpha > 0.60$ ).

#### 4.2 Descriptive of Respondents and Variables

The number of respondents of this study was 200 businessmen of informal sector. It consist of 150 businessmen from the Makassar city and 50 businessmen from the Pare Pare city. Respondents of the study is described based on age, gender, ethnicity, business, business experience and status of business. Dominantly respondents have age of between 20-40 years (80%), male (86%), from the tribe of Makassar (74%), business in the field of food and beverages (60%), have experience of business between the 2 to 10 years (78%), and their business is the main business (82%).

Furthermore, mostly business of respondent have sales between 1-50 million (92%), business assets of 1-5 million (88%), have a workforce of 1-5 people (64%), the business capital of 5-10 million (66%), with a net profit of 10-50 million (72%). Then, the main capital is used in the operations came from their own capital (90%). Generally, respondents in increasing sales by improving customer service (80%). Sales of business reach on target (70%), and the projected sales are expected to increase in a relatively small amount (50%). This is an indication that at this time informal sector is growing but slowing. Therefore, the informal sector entrepreneurs are expected to increase sales revenue through making better service to customers.

Descriptive analysis also showed that an average of the respondents strongly agreed (4.20) if the business location being close to the market. Most of the respondents don't agree if the location of their business is concentrated in one place (2.20). Then, stable business conditions creating (3.80) with excellent business prospects (4.28) in line with the economic growth in the future. Then, the average respondent needs business loans assistances (4.38). Entrepreneurs access to credit and its requirements are quite easily. Financial institutions is quite a lot, both banking institutions such as

BRI, Bank Mandiri and BNI as well as non-bank institutions such as cooperatives. Similarly, the provision of credit facilities for business development.

Based on the analysis of Analytical Hierarchy Process (AHP), the contribution of the informal sector in the study could be observed in four aspects, namely: (1) provider of employment, (2) source of local revenue (PAD), (3) source of income of the people, and (4) its role in reducing poverty. The results of the perception of respondents based on the average value can be presented in the following table.

**Table 2.** The average value of respondents' perception on the contribution of the informal sector

No.	Contribution of the informal sector	Mean	Priority
1.	Provider of employment	4.12	2
2.	Source of local revenue	2.86	3
3.	Source of income of the people	4.24	1
4.	alleviating the poverty	2.96	4

**Source:** data processed, 2015

According to the table, it could be concluded that the informal sector must contribute more as source of income of the people than as a provider of jobs, reducing poverty, and source of local revenue.

#### 4.3 Potential and Problems of Informal Sector

Based on the processing of field data, the following was stated potentials and problems faced by informal sector enterprises in South Sulawesi as presented in the following table.

**Table 3.** Data of Potential and Problems of Informal Sector

No.	Potential	No.	Problems
1.	Ability to face the economy crisis	1.	Lack of support from the government (central / local)
2.	Provider of employment	2.	Access to capital is relatively difficult, because of administrative issues
3.	Source of local revenue	3.	Business management (conventional)
4.	Alleviating the poverty	4.	The low of labor skills
		5.	The difficulty of marketing network
		6.	Retribution fee
		7.	City spatial policy
		8.	No business license
		9.	Business competition highly
		10.	the existence of illegal charges or extortion

**Source:** data processed, 2015

The table shows that besides have some problems in its development, the informal sectors also has good potential if they are developed. The potential of informal sector enterprises include: (1) the ability to survive in the economic crisis (2) source of jobs or livelihoods of communities, (3) contribute in poverty alleviation, and (4) potential sources of government revenue. In various limitations as well as in situations of economic competition is high, the informal sectors had demonstrated their ability to survive in facing of economic crisis. The informal sector has created jobs for those who don't have the opportunity to work in the formal sector. Therefore, urban informalisation can create jobs and alleviate poverty in urban areas. Whereas, the problems of informal sectors include lack of support from the government, access to capital is relatively difficult, because of administrative issues, business management (conventional), the low of labor skills, the difficulty of marketing network, retribution fee, city spatial policy, no business license, business competition highly, and the existence of illegal charges. The role of the informal sector is very strategic in reducing unemployment in urban areas. In many major cities, when the crisis hit Indonesia and unemployment occurred everywhere, then the chance is the only one who can save the survival of millions of workers who suffer termination of employment and unemployment are the informal sectors. (Hidayat, 1978; Demba, 1999; Firnandy, 2002; Haris, 2011).

The weakness of the process of empowerment of the informal sector is not only due to a limited budget, but also

the policy of the government (central / local) support in the informal sector wisely. On the other hand, the informal sector players do not have good management that make them work efficiently and have a strong bargaining power in the market. Factors limited capital and access to markets and the main obstacles can not be overcome with good. The informal sector also do not have a strong business network. the informal sector is also seen as a destroyer of the beauty of the city, so it should be regulated by the government (Suharto, 2002; Alam, 2004, Alam *et al.*, 2015).

In general, urban spatial planning actually has a plan to move the informal sector at a place by reason of city beauty, cleanliness and regularity of city. The informal sector as street vendors (PKL) is often considered as an element that could make the city dirty and untidy, causing traffic jams, throw garbage in any place and bother the activities of pedestrians (Alam, 2004; Widyaningrum, 2009; Brotosunaryo *et al.*, 2013).

#### 4.4 Priority Factors and Informal Sector Development Strategy

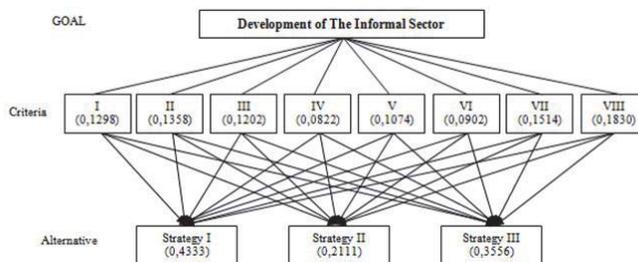
Determining factors priorities and formulation of development strategies could be done by using Analytical Hierarchy Process (AHP). In the preparation of the hierarchy to formulate development strategy, there are several components which is divided into three levels, namely objectives, criteria and alternatives. Value weighting of criteria or influential factor in considering options strategies could be presented in the table.

**Table 4.** Weights and Criteria of Informal Sector Development

No.	Criteria	Weights	Priority
1.	Access to capital	0.1298	4
2.	Business management	0.1358	3
3.	Labor skills	0.1202	5
4.	Urban spatial policy	0.0822	8
5.	Legality / licensing	0.1074	6
6.	Business competition	0.0902	7
7.	Government support	0.1514	2
8.	Support of related institutions (PT, NGOs, etc.)	0.1830	1

**Source:** data processed, 2015

From the eight criteria for deciding the development of the informal sector, support related institutions was ranked first priority (0.1830), followed by government support as second priority (0.1514), and business management as the third priority (0.1358). Furthermore, the hierarchical structure of alternative electoral strategy could be viewed on the following figure.



**Figure 1.** The Hierarchy of Informal Sector Development Strategy

The weighting value of alternative strategies was obtained by calculating the average of geometry, thus obtained weighting for each alternative strategy. There are three alternative strategies that could be used in the study as follow: (1) coaching, (2) formalization (legal / business licensing), and (3) the localization, the availability of informal sector location centers. The complete results of the weighting and the priority of informal sector business development strategies were presented in the following table.

**Table 5.** Weights and Alternative Strategy of Informal Sector Development

No.	Alternative Strategy	Weights	Priority
1.	Coaching	0.4333	1
2.	Formalization (legal / business licensing)	0.2111	3
3.	The localization	0.3556	2

**Source:** data processed, 2015

According to the table and the figure above, it could be known that the order of priority from 1 to 3 in the development of the informal sector as follow: (1) coaching, (2) localization, availability of informal sector center and (3) formalization, transformation of informal sector to formal sector by business licensing. Therefore, development strategy of the informal sector business have to focused on coaching, creating of location centers of informal sector enterprises, and formalization. Development of the informal sector requires the support and commitment of all stakeholders such as universities, NGOs, private sector, and government through related institutions / organizations. In addition, development activities must be supported by several other important activities such as baseline survey of informal sector enterprises, capital assistance, training, dissemination of local regulations particularly the policy of city planning, and providing support to the informal sector who want to move to formal sector through business licensing administration which more easy.

## 5. Conclusion

Some of the problems faced by the informal sector are lack of government support, access to capital is quite difficult, problems of business management, low labor skills, lack of marketing network, retribution fee, city planning policy. Generally, they also don't have business license, competition problem, and the existence of illegal charges. Therefore, the informal sector business development strategy should be more focused on coaching and providing centers of informal sector enterprises and also business formalization. Development of the informal sector requires the support and commitment of stakeholders such as universities, NGOs, the private sector, and government through the role of related public sector institutions. In addition, development activities must be supported by several other important activities such as baseline informal sector enterprises survey, providing locations or centers of businesses for informal sector, capital assistance, training, dissemination of local regulations, particularly the policy of city planning, and providing support to the informal sector who want to switch on formal sector simplify. Moreover, developing of the informal sector in the future should be done local Governments with stakeholders such as universities, private sector, NGOs in improving the capacity of human resources in business management, institutional development and financial management.

## References

- Alam, Syamsu, Maat Pono, Musran Munizu. (2015). Model and Strategy of Business Development and The Role of Informal Sector in South Sulawesi: Case of Makassar and ParePare, Self-report, Makassar: Unpublished.
- Alam, Syamsu. (2004). Analysis of Factors Affecting of Informal Sector Performance in South Sulawesi: Case Makassar, Pare-Pare and Bone, Dissertation, Hasanuddin University, Makassar: Unpublished.
- Becker, K. (2004). The Informal Economy: Fact Finding Study, Stockholm: SIDA
- Brata, Aloysius Gunadi. (2010). Vulnerability of Urban Informal Sector: Street Vendors InYogyakarta, Indonesia. Theoretical and Empirical Researches in Urban Management. 5 (14): 47 – 58.
- Brotsunaryo, P.M., Hadi Wahyono, Sariffuddin. (2013). Strategic Arrangement and Development of Informal Sector in Semarang, Riptek Journal, 7 (2): 71 – 80
- Dhembra J. (1999). Informal Sector Development: A Strategy for Alleviating Urban Poverty in Zimbabwe, J. Soc. Dev. Afr. 14 (2): 5-19
- Dimas, Harlan. (2008). Street Vendors: Urban Problem and Economic Potential. Working Paper in Economics and Development Studies (WoPEDS). Department of Economics, Semarang: Padjajaran University
- Firmandy. (2002). Study on Profile Workers in the Informal Sector and Future Policy Directions, Directorate of Employment and Economic Analysis, Jakarta: Bappenas
- Hair, Joseph F. Jr., Ralph E. Anderson and Ronald L. Thatam. (2011). Multivariate Data Analysis, New Jersey, USA: Prentice-Hall inc.
- Haris, Deden Muhammad. (2011). Development Strategy of Informal Sector Business in Support of Economic Growth and Poverty Reduction in Urban. Proceeding National Symposium on Regional Autonomy: 239-245.
- Hidayat. (1978). Role of the Informal Sector in Indonesia Economic, The Indonesian Financial Economy Journal, 26 (4): 415-443
- ILO (1972). Employment, Income and Equality: A Strategy for increasing productive employment in Kenya. International Labour Office, Geneva. 600pp

- Kent, D. W. and Mushi, P. S. D. (1995). The education and Training of artisans for the informal sector in Tanzania-Education. Research Paper 18:143 – 147.
- Muhanga, M. and Nombo, C. (2010). Local government policy responses to the informal sector in Morogoro, Tanzania: Seeing problems in an opportunity or seeing an opportunity in problems? *African Affairs* 28: 133 – 156
- Mulyono, Sri. (2002). *Decision Making Theory*, Jakarta: FEUI Press
- Setiawati, Ayu Prasetyo, Hari Rohmana, Jaelani, Ujang. (2000). *Analysis of Informal Sector Workers in Jakarta*, Jakarta: STIS Jakarta Press
- Suharto, Edi. (2002). Human Development and The Urban Informal Sector In Bandung, Indonesia : Poverty Issue, *Journal of Asian Studies* 4 (2): 115-133
- The Central Bureau of Statistics of South Sulawesi. (2014). *South Sulawesi in figures*, Makassar: BPS Press.
- Walther, R. (2011). *Building Skills in the Informal Sector*. Background paper prepared for the Education for all global monitoring report. Bonn, Germany 10pp.
- Widodo, Tri. (2005). *Informal Sector in Yogyakarta*, Yogyakarta: PSEKP Press
- Widyaningrum, Nurul. (2009). Urban and Street Vendors, *Journal of Social Analysis*, 14 (1): 10-18
- Yatmo, Yandi Andri. (2009). Perception of Street Vendors as Out of Place Urban Elements at Day Time and Night Time, *Journal of Environmental Psychology* (29): 467 – 476.