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SPOTLIGHT

WHY INNOVATION AND DIVERSIFICATION IS IMPORTANT IN THE INFORMAL ECONOMY?

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Key Points

- Innovative and diversified enterprises comprise only a small part of the huge common informal economic activities undertaken by the majority of entrepreneurs in Papua New Guinea.
- Innovation is led mainly by males with higher levels of education, training and skills in respective sectors.
- Major challenges continue to constrain the growth and expansion of innovative informal economic activities.
- Policy intervention should focus on research and development of cheaper local materials, resources and technology to facilitate the growth and expansion of innovative enterprises which can become sustainable and transition to Small and Medium Enterprises (SMEs).
- Most 'survival' entrepreneurs who struggle to meet daily needs may not make this progression to SMEs, but it is equally important to provide an enabling environment for their activities to be more productive and provide a sustainable source of livelihood.

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WHY INNOVATION AND DIVERSIFICATION IS IMPORTANT IN THE INFORMAL ECONOMY?

By Elizabeth Kopel

Informal economic activities cover enterprises in all sectors that are not registered with the Papua New Guinea (PNG) Investment Promotion Authority (IPA). More than 80 percent of the country's population depends on informal semi-subsistence sources of livelihood (Sowei et al., 2010). Much of the informal economic activity occurs out of necessity to meet survival needs (Kopel et al., 2017).

Though the potential for informal economic activities is as big as the economy, research has shown the lack of diversity in scope, range and the nature of informal economic activities (Eugenio, 2001). Fortunately, there are pockets of innovation of informal economic enterprises which can serve as models and set the pace for diversification, growth and expansion.

PNG has taken an enlightened approach to address issues of the informal economy by elevating the status of the informal economy as an equal partner to the formal economy with a national policy and accompanying legislation to develop and regulate it.

The Small and Medium Enterprises (SME) Policy, accompanied by a SME Master Plan has the aim of expanding the number of SMEs from an estimated 50,000 to 500,000 by 2030. The policy aims to facilitate major changes in the growth, sustainability and transitioning of economic enterprises into higher value-added SMEs. Steady progress towards achieving this objective requires accelerated growth in innovative and diversified enterprises that are productive and sustainable, and can expand and transition into SMEs. Innovative enterprises require an enabling environment with appropriate support to overcome barriers and improve their activities and income through the use of efficient factors of production: technology, skills and methods of operation.

This paper is informed by a study (Kopel et al., 2021) that investigated innovation and diversification of informal economic activities in Eastern Highlands, Central, and National Capital District (NCD). Its objective was to document and draw lessons from enterprises and entrepreneurs who are at the helm of driving innovative and diversified informal economic activities. It was also to enable a better understanding of how innovative and diversified enterprises in the informal economy, as an engine for

growth, can be better supported through appropriate policy interventions.

What is innovation?

Research on innovation in the informal economy is a new field and not much information is available. Innovation is used here in a loose sense to refer to new ways of conducting common economic activities or engaging in completely new or uniquely rare economic activities, processes of production, technology or skills. Innovation is context specific as economic enterprises or methods of production considered as innovative in one location or period may not be so in other settings. Activities common in one location may be transferred to other locations in which they serve as new models for a different population. Innovation enables the formation and growth of diversified activities with a comparative advantage, profitable and can grow with some of these transitioning to formally registered SMEs.

Who drives innovation?

In PNG, innovation is at its infancy with the majority of entrepreneurs engaging in common, non-innovative economic activities, essential for meeting daily survival needs and enhancing livelihoods. These entrepreneurs would benefit from extension services and short-term skills training opportunities which can enable them to diversify their economic activities and improve income. Over time, some of these entrepreneurs can innovate, expand their activities and transition to formal SMEs.

Some people pursue a personal interest or hobby through informal entrepreneurship which has become an economic activity, while others engage in informality as a side business to supplement household income. Yet, the potential to drive innovation and diversifying the informal economy lies in the activities of those who are educated with specialised knowledge and skills in specific sectors such as agricultural extension workers or have a spark of originality in responding to market demand for certain goods or services.

Most innovators are largely male entrepreneurs so any effort to increase women's engagement in innovation and diversification of their enterprises would require targeted education and training programs and skill-building opportunities for women alongside other interventions such

as adult literacy and financial inclusion efforts. Innovators live and operate in communities, sharing their skills and knowledge where extension services may not be available. They provide informal training and employment for young people who often start out as helpers and learn basic skills under supervision.

Often, entrepreneurs sell what they produce with a few instances of aggregation with some very interesting innovative activities. The growth and expansion of the informal economy can create greater employment opportunities and income in both rural and urban areas. However, the opportunity for innovators to grow their enterprises is constrained by technical and resource limitations.

Major challenges limiting the growth and expansion of innovative enterprises

The challenges that constrain innovative enterprises are widespread and exist across industries and activities, ranging from production and sale of fresh produce to manufacturing/ downstream processing and provision of services. A number of major areas of challenge emerge from the study this article is based on (Kopel et al., 2021). These challenges mirror the same issues identified by previous studies (Eugenio, 2001) and include: lack of finance, shortage of technical and material resources, access to markets and high competition as well as high cost of transportation and lack of skills and knowledge.

Lack of finance: The capacity of innovative informal businesses to grow is limited by lack of finance. Most enterprises have not benefited from formal sources of finance and they are highly dependent on informal, personal and family sources.

Shortage of technical and material resources: Materials and equipment are extremely expensive. As most of them are imported, the high costs pose a major barrier for informal entrepreneurs. Incentives for local industry to produce and promote the use of local equipment and materials at cheaper costs to replace imports are yet to be developed.

Need for better access and connectivity: Access to improved roads and affordable transport is also a key challenge and a major issue that has also been noted by previous studies (Sowei et al., 2010). Poor infrastructure and lack of transport services constrain free and easy movement of people, goods and services and this affects progress of innovation in the conduct of economic activities.

Lack of skills and knowledge: Shortfalls in technical skills and knowledge is an issue for those with limited education. Innovation, using new technology and methods of production requires knowledge, skills and capital, but many

entrepreneurs lack these inputs. This partly explains the lack of diversity in activities, leading to oversupply, strong competition and poor sales which are recurring themes. This evidence raises the need for policy interventions to be strategic and holistic, from different entry points to address a range of different issues simultaneously.

How innovative enterprises can be enabled to grow

A good starting point for intervention to promote innovation and diversification would be to support informal enterprises established by trained people with specialised skills and those with a spark of originality. These enterprises are most likely to grow, become sustainable and transition to formal SMEs; thereby, contributing to achieve the SME policy target of reaching 500,000 SMEs by 2030.

Most 'survival' entrepreneurs who struggle to meet daily needs may find it difficult to make this progression, but it is equally important to provide an enabling environment for their activities to be more productive and provide a sustainable source of livelihood.

Key areas for policy intervention

Development of cheaper local materials and equipment.

Actively search for ways to stimulate the local industry to develop comparatively cheaper culturally and technically appropriate alternatives to imported materials and equipment. Promote initiatives that can reduce costs for informal entrepreneurs and provide incentives for research into the development and production of cheaper local products and equipment.

Access to finance

Currently, up to 98 percent of informal enterprises are self-funded, and any borrowed funding comes from informal sources (Kopel et al., 2021). Micro finance institutions (MFIs) such as the Women's Micro Bank serve low income clients and are progressively entering the rural and informal market using mobile technology. More needs to be done to enable MFIs to spread the depth and breadth of coverage, while also creating awareness of this opportunity among informal entrepreneurs. This requires an extended partnership approach for the government to work in collaboration with MFIs, donor partners and other key stakeholders.

Financial literacy and competency training

There is a need to facilitate sustained collaboration between MFIs, donor partners and non-government organisations interested in working with informal entrepreneurs to address financial literacy and competency needs.

Address specific training and skill-building needs of informal entrepreneurs.

Collaboration between government, donor partners and non-government organisations is essential to address targeted training and skill-building needs of innovative informal entrepreneurs. Such training needs to be tailored and appropriate for respective beneficiary groups.

Improved markets and basic services

Entrepreneurs of certain activities such as metal works, artefacts and floriculture operate in the open at the mercy of the elements. Markets should be functional, sustainable and located in places suitable to the convenience of both buyers and sellers. Providing strategically located and adequately serviced specialised markets would enable entrepreneurs to easily sell their products and services.

Conclusion

Innovation and diversification of informal economic enterprises are established and operated mainly by educated and trained individuals with specialised skills and knowledge. State intervention must focus on developing strategies that can assist enterprises which demonstrate promising signs of innovations and diversification. These enterprises have the potential to grow, become sustainable and transition to SMEs.

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