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# **A Comparative Study of Women in Formal and Informal Businesses in Jigjiga City, Ethiopia**

*Characteristics, Linkage, Challenges and Way forwards*

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## 1. RATIONALE OF THE STUDY

Business in the Somali Region is dominated by informal sector. Gender aspect is another important feature of the economy in the case of Somali Region, where women are key drivers of the economy. A particular role of women in the economy is their participation in the urban informal sector. For example, in March 2012, women in the informal sector constituted 68.5% of the labor force in the urban areas, where the share of men in the same sector was 42.2%. In April 2014, the percentage of women aged 16 and above involved in the informal sector accounted 57.2% (as compared to 32.7% figure that goes to men) of the total work force in the urban areas in Somali Region. As of June 2018, it was reported that Proportion of persons in the urban area who Work in the Informal Sector accounts 27.8% (22.3% goes to men) of the total labor force in the region (CSA, (2018). As a reflection of the regional figure, one observes the informal sector businesses dominated by women in Jigjiga city, the capital of the regional government (Wubeshet and Habtamu, 2016).

In essence, studying formal and informal sector business helps understand the nature, dynamics and linkages of business among the two sectors in general. Moreover, such a study enables to identify particular (unique) and shared factors that affect the businesses in the economy (Mai Ahmed Abdelzaher, 2019). Therefore, studying the businesses operated by women in both formal and informal sectors in Jigjiga city is telling a lot on the nature, structure and dynamics of the economy of the Somali Regional state of Ethiopia. It is on the background of the above issues that the essence of this study is justified

This study is aimed at making inferences on the general picture of businesses in the Somali Region, with a focus on women operated business units both in the formal and informal sectors of the economy. To that end, the study makes analysis and inferences on the following four interrelated issues, which comprise the objective of the study:

- Investigate the major factors that causes women to participate in the informal sector in Jigjiga city
- Undertake a comparative analysis on the essential characteristics of businesses operated by women in Jigjiga city.
- Investigate the types, depth and determinants of linkages between formal and informal businesses
- Identify the major opportunities and challenges of formal and informal business units operated/owned by women in Jigjiga City

## 2. MATERIALS AND METHODS

### 2.1. Sampling Design and Data Sources:

The sample population of the study involves two categories of respondents: women in the formal sector and Business women in the informal sector. The sample size is determined on the basis of subjective sample selection criterion pertaining to the goal of the study. Given the nature of the study, the sample size of 100-120 is an optimal sample size (Majumdar, A. 2014). Hence, the study sampled 109 business units owned/run by women in Jigjiga City. A proportional sample was taken from the two sectors, where 50 businesses units were selected from formal sector and 59 from the informal sector.

The study heavily relied on primary data sources as source of information and inference. Therefore, quantitative and qualitative data were gathered through structured questionnaires and focus group discussions (FGDs). Field observation also takes an important source of information. The questionnaire administered was in line to address the objectives of the study, where questions intended to draw information on the socio economic characteristics of women entrepreneurs as well as on the pattern of linkage between the formal and the informal business units.

A cross sectional survey of questionnaire was undertaken on informal and formal businesses operated by women in Jigjiga City. The data was collected in June and August 2019.

### 2.2. Techniques of Data Analysis and Tools of Inferences

The study employs a mix of quantitative and qualitative techniques of inferences. The quantitative analysis involves descriptive and econometrics tools. A descriptive technique was meant to infer on the socio-economic status of business in the formal and informal sectors. Moreover, the descriptive analysis depict on the essential drivers to informal sector involvements.

The logistics regression is used to investigate determinant factors of linkages between formal and informal businesses.

#### ***The Dependent Variable***

The endogenous variable is probability of linkage between formal and informal businesses. ***Linkage (LNKGE)*** is a binary dummy variable.

***LNKGE =0*** there is no linkage of formal business units with informal businesses

***LNKGE =1*** there is linkage of formal business units with informal businesses

### ***Explanatory Variables***

From theoretical and empirical literature, linkage between formal and informal sectors is determined by a number of variables. These are:

*Registration of the Business (REGIST), Start-up Capital (STARTCAP), income of the entrepreneur (INCOME), access to credit facility (CREDIT), Operation on Full Time Basis (FTIME), number of workers (WORKERS), Access to training (TRAIN), future expansion plan (EXPAND), Rental status of the premise of operation (RENT).*

Hence, the Logistic Model to be specified assumes the following:

$$\mathbf{LNKGE = REGIST + STARTCA + INCOME + CREDIT + FTIME + WORKERS + TRAIN + EXPAND + RENT}$$

### 2.3. Definition of Variables

Variable	Definition/Measurement of Variable	Hypothesis
<b>Linkage (LNKGE)</b>	Linkage is a dummy dependent variable. The dependent variable (i) pertains to the probability that a formal sector enterprise has backward and forward linkages with the informal sector. The existence of formal business linkage with informal sector takes a value "1" and its absence is coded with "0"	
<b>Registration of the Business (REGIST)</b>	Registration provides legal prohibition for the business units which will restricts linkages with the informal units. The Business units which are registered are coded as "1" and absence of registration is coded as "0".	Registration, thus, is assumed to affect the forward and backward linkage between formal and informal businesses negatively.
<b>access to credit facility (CREDIT)</b>	Availability of credit from formal financial institutions, like banks and/or microfinance institutions. The variable is a binary variable with its presence coded as "1" and its absence coded as "0"	Formal sector units having access to formal finance sources limits their linkage with the informal sector as source of finance or business transactions.
<b>Start-up Capital (STARTCAP)</b>	startup capital is the amount of Initial investment It is a continuous variable and takes the amount reported by respondents	The higher the initial Investment level of the formal businesses the less likely to have linkage with informal sector
<b>income of the entrepreneur (INCOME)</b>	Income refers to income of women entrepreneurs in the formal sector generated in a certain period interval. In this study, Income is a continuous variable assuming the value reported by women in the formal business per month	The higher the income in the formal sector, the less likely it has a linkage with informal sector.
<b>number of workers (WORKERS)</b>	It is a number of workers employed by the formal sector business unit. The value is depicted as reported by women in the formal business	Number of workers affects the plausible interaction between the formal and the informal sector. The formal business units with large number of workers are assumed have less linked with the informal sector as they are better organized than the units with smaller number of workers
<b>Access to training (TRAIN)</b>	This variable denotes access to training on businesses. In this study, training is defined as access to capacity building training by women in the formal business units. Hence, businesses run by the trained women entrepreneurs are coded as "1" and those run by entrepreneurs without training are coded as "0".	
<b>Future expansion plan (EXPAND)</b>	This variable represents the anticipated growth of the enterprise. This is measured by the intention for future expansion and their attitude towards profit. Those business units which intend to expand in near future are coded as "1", and "0" otherwise.	Those formal units which feel that their profit is increasing in recent times are less likely to procure raw materials/ intermediate goods from the informal sector to speed up the production (as informal sector is unable to supply in large scale). Similarly those units which intend to expand in near future are assumed to have negative impact on their linkage with the informal sector.
<b>Operation on Full Time Basis (FTIME)</b>	This variable represents whether the business unit operate in full time or part time basis, as reported by women in the formal businesses. Those units who report full time operations of their respective business are coded as "1", and "0" otherwise.	The enterprises which operate on a full time basis are less likely to establish both backward and forward linkages with the informal sector.
<b>Rental status of the premise of operation (RENT).</b>	Is a business women report on the rental status of their premises as rented or owned. Those who report as owned assumes a value of 1 and those who report they their working premises are on rental basis are denoted as 0.	Having permanent location, as measured by the variable rented premise, helps a formal unit to not to establish linkage with the informal sector, because such an act would erodes the businesses' reputability by other formal businesses in its neighborhood. , it also exposes itself to be tracked by regulatory bodies

## **2.4. Reliability and Robustness Test on the Estimation from the Logistics Regression**

To check the reliability and robustness of the data and model, the regression model will use appropriate statistical tests and procedures that logistics regression model requires.

The overall fit of the logistic regression model is tested by 'Omnibus test of the model coefficient' and the 'Likelihood ratio test'. The significance of the individual predictors is given by the score test or the Lagrange multiplier test. The significance of the individual parameters is also tested by constructing correlation coefficient matrix which confirms the results of the score test.

### **3. FINDINGS AND DISCUSSION**

#### **3.1. Socio-demographic Characteristics of Women in the Informal and Formal Sectors**

With regards to the age structure, the majority of respondents were in the age bracket from 20-50 years, with respective share in this age bracket in the formal and informal sectors accounted 94% and 84% respectively. In both cases, the sample data shows that the majority of business women are in child bearing ages. That signals business women have dual responsibility of performing house work and in income generating businesses to their families.

Moreover the age structure of sample respondents reveal that while the informal sector is dominated by youth women, the formal sector is dominated by adult age groups. In this regard, 56% of respondents in the informal employment were aged below 30 years. The figure was 30% for women in the formal sector employment.

The demographic analysis results show that informal sector employment has important links with migration and youth unemployment issues. This finding is in consistent to findings on factors driving to informal sector, where a majority of respondents reported that lack of alternative employment as main reason why they involved in the informal sector.

#### **3.2. Factors Driving to Participation into Informal and Formal Business**

With regards to causes of participation into the informal businesses, the study found out that lack of alternative employment opportunities a major push factor, with a response rate in this regard was 53.85%. The second major driver was low income in the formal employment, where 28.2% of women reported in this regard. School drop-out is identified the third major factor that drive women to informal sector economy, with 7.6% of respondents in this regard. Demographic factors like divorce and death of husbands/parents were also reported driving women to look informal sector as source of livelihood. Moreover, a majority of women in the informal sector were economic migrants destined to Jigjiga from other parts of Ethiopia, accounting 71.19% of sample respondents.

The study also considered reasons to start business by women engaged in the formal businesses. In this regard, women entrepreneurs responded that their engagement was driven mainly as an alternative source of income (56%) and as source of livelihood (28%). Business start-up as a family tradition and a source of employment was also raised each by 8% of respondents.



### **3.3. Types, Depth and Determinants of Linkages between Informal and Formal Sectors**

The study also investigated the types, depth and determinants of linkages between the informal and formal sectors. In this regard, five types of linkages identified: as source of raw materials, cliental linkage, sourcing labor, as source of information and as source of capital. The study findings reveal that informal sector the major source of inputs for formal sector participants as a source of raw materials and as a source of labor.

The depth of linkage is found out to be very high. In this regard, 74.4% of businesses in the formal sector reported to have linkage with informal sector at least in one or more of the aforementioned five aspects of linkages. To understand on the determinants of linkage between formal and informal business units, the study employed logistics regression model. The finding in this regard shows that initial investment capital (start-up capital), access to credit and rental status business were significant factors in relation to linkages.

The logistics regression result shows that the start-up capital and linkage are negatively related, implying that the higher the initial investment by businesswomen in the formal sector the less likely to have linkage with the informal sector. On average, businesses with higher start-up capital are 0.0000703 times less likely to form linkage with the informal sector. This finding complies with the findings from the descriptive analysis, where negative correlation between linkage and start-up capital identified.

Business women`s access to capacity building trainings was another variable having negative association with linkage. The coefficient of this variable was estimated as -0.51894, indicating women in the formal sector with access to capacity building training were less likely to have linkage with the informal sector, on average, by probability factor of 0.51894. This findings complies theoretical and empirical justifications. Moreover, the findings confirm the result from correlation analysis made under the descriptive part of the study, where access to training by business women is negatively associated to linkage with informal sector.

The rental status of premises of business units is another significant variable with positive association with linkages. According to regression result, business units rented are more likely to link with the informal sector than businesses operated in buildings/homes/warehouses owned by businesswomen. In this regard, the probability of linkage with informal sector of businesses whose premises are rented as against to those operate using premises of their own is higher by a probability factor of 2.2, on average. This is incompatible with the hypothesis laid by the study. One assertion why business units which use their own buildings less likely link with informal businesses is that the cost of linkage is dear if they do so. Having own businesses

premises and working with the informal businesses risks the probability of getting tracked by the regulatory body of the government or custom inspections.

The regression result also revealed on the importance of informal sector as source of labor for formal business units. The coefficient of this variable was 0.2532, signaling there is a positive association between the number of workers and linkage. Accordingly, those formal business units having one more labor are more likely to have linkage with the informal sector by a factor of 0.2532, on average. This finding is confirmed by findings from descriptive analysis of the study, where the correlation analysis depicted a positive association between number of workers by a business units and its linkage to informal sector. Moreover, the finding is in compatible with another finding from descriptive analysis where 80.8% of formal business units reported the informal sector as their major source of labor.

The regression analysis further shows that formal business units having access to credit are more likely to link with informal sector. This finding is against the hypothesis laid by the study. One assertions given by empirical studies why access to credit limits linkage with informal businesses is that the lending institutions (banks) request businesses to come up with business transactions made in invoices. In the context of business women in Jigjig, such financial information are not a precondition to get credit given the major sources of credit reported by respondents were microfinance institutions. And the researcher has learnt that microfinances do not consider customers' financial information mandatory to provide credits. Perhaps, this is a likely reason why access to finance and linkage are not correlated in a way suggested by empirical findings.

Another variable in the regression having positive association with linkage was the scale of business operation (in this study represented part time operation against full time operation), where the coefficient of this variable is estimated as 1.81. Accordingly, businesses in in the formal sector working on part time basis are more likely to have linkage with the informal sector, with a probability factor of 1.81 that formal businesses working on a full time basis. The finding in this regard is consistent with theoretical assertions and evidences from empirical findings of similar studies. The correlation analysis of this study, as depicted under the descriptive part of discussions, also confirms the probability of positive association between formal businesses operating not on full time basis and linkage with informal sector.

The income level of business units and the current working capital were positively associated, with the value of respective coefficients estimated 0.1622 and 0.1857. The findings were against the hypothesis laid

in the study. However, the field observation of the researcher and FGD results from discussants suggest so despite the hypothesis laid by the study pertaining previous empirical evidences. Moreover, this finding confirms results of correlation analysis made in the descriptive part of the study.

One justification that can be made for the positive association of those variables with informal sector linkage is contextual factors surrounding the business environment in the Jigjiga City. As a matter of fact, business in the city of Jigjiga is dominated by informal sector, and without any linkage of the formal business units with the informal sector, their performances would be at stake. That is a likely condition that business units in the formal sector with higher income and current capital are those who are linked with informal sector.

### **3.4. Major Challenges Faced by Informal and Informal Business Participants**

The study also explored on existing challenges faced by business women engaged in informal and formal activities.

#### **3.4.1. Challenges Faced by Informal Business Participants**

The main problems raised were working place problems, lack of access to credit to expand their businesses; business recognition and work security challenges. In this regard, the study found out that 31.4% respondents reported to have faced the problem of housing/working place. About 24.8% women had the difficulty to access capital.

Another challenge raised by respondents was the view of government bodies on their undertakings as biased. Despite the importance of informal businesses in absorbing large size of unemployed labor forces and a source of income for considerable size of families, informal sector operators let alone receiving various supports from government bodies, are considered illegal. The respondents emphasized the notion that informality does not mean illegality. Respondents stated that whatever supports and assistances comes to business community goes to formal sector operators

The researcher of this study tried to communicate relevant government bodies in Jigjiga City to address the issue. According to government officials, informal sector activities in the city have been increasing time after time. The bulk of informal sector engagements involves in activities like petty trading, street vending, home based food and beverage sales, etc.

Government officials acknowledge, though in words, on the role of informal businesses vital as source of employment for an increasing labor forces in Jigjiga city and in mitigating the burdens of increasing level of urban poverty, in action however, there seems confusion on the issue at hand. The government officials subjected for this study raised the need to endow support for informal sector participants, but the legal issues and perceived look into the informal sector as illegal is a major barrier for any possible capacity building interventions.

For instance, one official said this:- *"Even if informal activities have so many valuable roles, interventions to enhance their businesses means promoting informality and illegal activities by discouraging formal sector operators. Such a case would even incentivize participation in informal sector where formal sector operators inevitably transform into informality"*.

#### **3.4.2. Challenges Faced by Formal Business Participants**

Women entrepreneurs in the formal businesses were asked for any problems they are encountering in their venture. The major challenges raised were structured in the questionnaire into five main dimensions to rank in order of importance: financial, Social, self-sufficiency, economic and social justice related problems.

The finding of the study reveals that the three most raised problems in order of importance were: social, self-sufficiency and financial. A majority (79.5%) of businesswomen reported the major challenge in their ventures was social problems. Amongst the list of mentioned social problems, traditional norms and values was by far the major hindrance for their successful business undertakings.

The second major challenge was attributed to self-sufficiency issue, where 75% of respondents agree or strongly agree for the problem to prevail. In this regard, heavy workload aspect of self-sufficiency problem was mentioned for being core challenge in their business moves. This is attributed to over burden in time and energy women entrepreneurs has to lend to family care and management, in addition to their business activities.

The least mentioned problem was financial challenges. This, in part, is explained by the unique fabric of the communities of interest of this study, where the stock of social capital is immense where business people have good record/tradition of sharing resources (including financial). For instance, as reported by business women, social capital (transfers/loan/gift from families and relatives) consist major source of finance as a

start-up and/or investment capital for their businesses. Please see the case study below for more on the role of social capital.

#### CASE STUDY

##### SOCIAL CAPITAL AS MODERN CREDIT CARD SYSTEM IN SOMALI COMMUNITIES

*(This case study is based on a book titled Habtamu Demiessie (2019), The Fabrics of Eastern Ethiopian Communities: Involuntary Simplicity, Individualism and Wellbeing, Scholars Press, ISBN: 978-613-8-91190-6)*

The Somali people in Ethiopia as Somali elsewhere in the horn of Africa are structured and organised on the basis of clan and sub-clans (lineages) which either binds or divides depending the level allegiance. Such social organisation form the basis of much of social institutions and norms of traditions or Xeer including Rights to resources, personal Identity(Af-tirsin), customary law(Xeer), blood compensation group(mag-paying), and support system. The mag-paying and support system have complex allegiances. The later can have members who are either blood related or traditionally adopted who do not change clan allegiance in times of alliances and adversarial threats.

A crucial feature of the Somali Region economy, easily overlooked by analyses that focus on pastoralism in isolation, is the interconnected nature of different livelihood activities. Capital flows occur around this system because pastoralists sell animals to traders and buy food produced by farmers and agro-pastoralists; relatives with jobs in urban centers invest in the rural economy; other relatives living abroad remit cash back to the region. This dynamic and complex set of economic relationships is a source of strength but also a source of vulnerability, as any threat to one set of actors in the system can undermine the livelihoods of many others. the economic system is to be viewed holistically as “a complex interconnected system” in which a system of social networks where the sustainability or vulnerability of each livelihood depends as much on the individual’s interpersonal relationships as on his or her assets and income at any point in time. Viewed from this basic structural outlook, the Somali pastoralists in the study area are Socio-economically organized in a way that is so unique that, it has interesting special traits. Socially, they are organised in a clan basis; economically they established a social credit system. The clan set-up complements the social credit system. The clan organisation sets rules and regulations that helps a smooth economic order of Somalis. The economic order, although with some unique features, resembles the modern credit card system.

There are a number of reasons for the Somalis to opt for social credit system. One key reason is that there is immense social capital that ties communities, a sense of livelihood based on cooperation. The other reason is that due to geographic location of the people of Somalis in that they are living in drier areas, making them susceptible to recurrent drought. Hence the social credit system is the best option to cope up with uncertainties attached with sustaining livelihood. The social credit system is too sophisticated and has worked for generations without failure. Unlike the modern credit system, the social credit system is free of interest payment; also there is not binding time for repayment if the creditor encountered problems that s/he unable to withstands. Totally the system is based on cooperation and not on profit seeking business like the modern credit system. This is the very element that kept the system alive for centuries without failure.

In line with improving the socio-economic status of pastoralists and helping to realize sustainable development, the traditional credit system prevailing has four important elements. The key element of the system is that it is built on **value of trust**. The other feature of the system is that, it is conducive to bring about **economic justice**; the third aspect worth to consider is that the system functions with **little side effects**, from socio-economic and environmental perspective. Moreover, the traditional system operates with **little transaction cost** and maintaining the system is easy. One should not forget that, given a condition of recurrent drought in the area and the largely aridity nature region, there has to be functioning risk management mechanism to sustain food scarcity and ecological imbalances.

#### 4. Conclusion and Recommendations

Informal sector plays a significant role in the socio-economic development process of poor countries like Ethiopia. In the case of the target communities of this study too, informal businesses is source of employment for unemployed and major source of income for considerable households. Despite the significant role of the sector in reducing unemployment and in fight against poverty, the sector in general and participants in particular do not get support and recognition from government and policy makers as they are considered illegal. However, **informality does not mean illegality**. Therefore, given the role and importance of informal businesses to local economy, the government/policy regime has to device inclusive policy arrangements where benefits that go to formal businesses can also be privileged by informal business operatives at least.

The study found out that business people look for informal activities not to evade tax. This contradicts the common wisdom on the matter at hand. The problem is cumbersome business registration requirements and tax administrations in formal sector arrangement are discouraging and rather incentivize to work underground. Therefore, the concerted segment of the government is expected to undertake massive reforms that tackle those problems. In this regard, policy regimes has to focus on legal, institutional and bureaucratic reforms which would mitigate doing business in the formal sector difficult

Furthermore, the study found out that informal businesses are by themselves complement businesses in formal businesses. The study reveals that informal sector is linked to formal businesses as sources of raw materials, sources of information, source of labor. The linkage between informal and formal sectors goes also as cliental, where formal/informal businesses were found to be final consumers of each other's products. Therefore, the policy regimes have to acknowledge that considering formal and informal businesses as interdependent. The policy implication in this regard is clear: it takes to create legal and institutional reforms which facilitate the way informal and formal businesses can function together. To that end, policy regimes can be considered instrumental to:

- Tap institutional resources between the formal and informal economies to fill institutional gaps.
- Reduce transaction costs of service and public goods provision
- Integrate business into poverty alleviation by building ties with informal markets and institutions

The study also concluded that migrant labor consist major players in the informal businesses. Migrants arrived in Jigjiga city to cross borders *en route* to middle-eastern Arab countries. More often than not, in any case their plans to cross borders may not hold, migrant prefer to stay in Jigjiga city and neighboring towns engaged/employed in informal businesses. This has an important policy implication connoting informal sector development an important variable which should be placed integral part of interventions in the realm of migration and urban development.

Last but not least, the study found out that social capital an important component of the economic environment, having facilitating role in business activities both in the formal and informal settings. The importance of social capital to business people goes as sources of information and start-up and/or investment capital. Social capital is also instrumental in reducing transaction costs in business transactions in general and in contract administration in particular. Trust is an important social commodity that business people use as collateral in exchanging resources like cash and property transfers. All in all, social capital has vital role in the business undertakings. Therefore, policy regimes have to capitalize on the stock of social capital in any interventions aimed at business development endeavors.

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