

The Roots of Informal Responses to Regulatory Change: Non-compliant Small Firms and the National Living Wage

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How do small ‘non-compliant’ firms (those evading existing regulations) react to further regulatory change? The impact of the National Living Wage in the UK in 2016 is analysed through 22 mostly longitudinal case studies of small non-compliant firms. The varied responses, endurance of non-compliance, and blurred and dynamic nature of transitions to compliance are discussed through the lens of institutional approaches to informality. The analysis sheds new light on the relative autonomy of micro processes and the conditions under which external forces affect these processes. Non-compliant informality, as a persisting feature of small business, is unlikely to be transformed by legal regulation alone.

Introduction

The understanding of the ‘informal economy’ has improved substantially since Webb *et al.*’s (2009) seminal contribution. In particular, informality is multidimensional. Firms may not comply with formal legal regulations and yet be seen as legitimate by their stakeholders and thus be distinct from both the formal and the renegade (illegal and illegitimate) sectors. Webb *et al.* (2009) distinguished between the two axes of business ‘ends’ and ‘means’, and between formal institutions, defining *legality*, and informal ones, defining *legitimacy*. Darbi, Hall and Knott (2018) added another axis, the degree of organizational infrastructure. These distinctions have important implications for policy and practice, as Webb *et al.*

(2009) propose that businesses combining legal ends (products or services) with illegal (but perceived as legitimate) means are those most likely to transition to the formal economy, in contrast to those with the aim of providing legal products in forms, such as untaxed or counterfeited, that are illegal. Businesses with legal ends and illegal means, which we describe as practising ‘non-compliant informality’, provide a key way of examining the boundaries between formality and informality and the conditions necessary for formalization.

A key limitation of institutional views such as Webb *et al.*’s is the presentation of the informal economy as the direct outcome of a gap between the macro (laws and regulations) and the meso (sets of norms that prescribe what is acceptable in a given context). If businesses sharing the same formal and informal contexts behave differently, additional factors and processes need to be considered. We focus on such processes in our study of how non-compliant firms respond to a major labour market intervention in the UK, namely the introduction of the National Living Wage (NLW)

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in 2016. Our conceptual approach extends the prevailing emphasis on meso-level studies of the informal economy (that is, the norms, values and beliefs of informal institutions; North, 1991). We identify a broader set of meso-level institutions that matter to non-compliant firms, notably sectoral established practices and networks (such as associations and agencies providing advice and support), and non-institutional factors, namely the changing power relations in the market and in the workplace. These relations are in turn shaped but not determined by conditions in the product and the labour markets (Edwards and Ram, 2006; Kloosterman, 2010). We pay particular attention to the dynamics within firms at the micro level that create and sustain informal practices, including the social relations between owners, workers and other relevant actors (that is, the 'labour process'). It is the relative autonomy of the labour process from external pressures that is key, as long stressed in the fields of industrial relations and sociology of work (Burawoy, 1979; Edwards *et al.*, 2006; Ram, 1994; Ram and Edwards, 2003, 2010). We therefore advance an integrated approach comprising social relations within the workplace, a wider range of meso-institutions that encompass the sectoral context of firms, and macro-level regulatory change. Using this approach, we ask 'how do managers in non-compliant small firms react to major regulatory change?' We cast light on neglected issues, including the durability of the 'informal economy', selective compliance, and why and how some firms move into formality (Darbi, Hall and Knott, 2018; Webb and Ireland, 2016).

The terms 'informal economy' and 'informality' need clarification, not least because the latter is a widely noted feature of small firms *per se* (Edwards *et al.*, 2006), but is sometimes mistakenly conflated with the evasion of statutory regulations. The 'informal economy' is an imprecise term with a variety of meanings. We view it as the paid production and sale of goods and services that are unregistered by, or hidden from, the state for tax and welfare purposes, but which are legal in all other respects (Williams, 2004). This definition distinguishes the informal economy from, on the one hand, the formal sector and, on the other hand, unpaid work and monetary transactions involving illicit goods and services. We define 'informality' as a process of workforce engagement, collective and/or individual, based mainly on unwritten customs and the tacit understandings that arise out of the

interaction of the parties at work (Ram *et al.*, 2001). As such, informality is a dynamic rather than a fixed characteristic, and is highly context specific. This definition embraces firms that are compliant with regulations, as well as those that are non-compliant. Our interest is in 'non-compliant informality', that is, firms in breach of formal regulations (in particular, the NLW).

We draw on 22 (mainly longitudinal) case studies of non-compliant small firms to examine how managers handle the major regulatory change of the NLW. Such a change in regulatory institutions, involving both an increased cost of compliance (higher minimum wage rates) and increased risk (new enforcement mechanism), could lead to different outcomes, from increased compliance to increased illegality. At the same time, we keep relatively constant the meso-level institutions that explain the perceived legitimacy of informal practices, by focusing on one geographic area and on a narrow cultural and ethnic setting, while we construct a sample with a wide variation of sectoral economic and workplace dynamics, as well as changing economic conditions over time. The findings reveal considerable variety of practice, a blurred and fluid relationship between formal and informal institutions, and tensions within firms belying the meso-level emphasis on shared norms: a more complex pattern than the idea of meso-institutions reproducing shared norms based on the legitimacy of non-compliance would suggest. Where compliance has occurred, dynamics within the firm, as well as shifts in the macro and meso-environment, are an important part of the explanation. For most non-compliers there is striking heterogeneity, including surprisingly many successful and dynamic performers. Only a tiny minority conform to the stereotypical depiction of the hidden struggler.

The opportunity to examine firms studied 10 and/or 20 years previously allows us to identify the roots of both enduring non-compliance and transitions to formality. The inclusion of workers is theoretically significant as well as methodologically distinctive because, despite no claim of workforce representativeness, it allows for an examination of both parties' values and norms (meso-level normative institutions), and the dynamics of consent and conflict in the workplace; in other words, it shows how managers and employees 'co-create and enact their contexts, draw on their cognitions and individual interpretations of contexts and

contribute to changes over time' (Baker and Welter, 2018: 386).

Theoretical background and controversies

Mainstream management studies tend to portray formality as a 'superior approach to the organization of economic life' (Godfrey, 2016: 8). The neglect of the 'informal economy' is being rectified (Bruton, Ireland and Ketchen, 2012; Darbi, Hall and Knott, 2018; Godfrey, 2011, 2016; McGahan, 2012; Webb and Ireland, 2016; Webb *et al.*, 2009). Its enduring relevance is highlighted by empirical work in the UK (Hammer and Plugor, 2016; Ram, Edwards and Jones, 2007). Clark and Colling's (2017) study of the UK's hand car wash sector is a recent example of an informal economy that is growing, rather than receding. A recent estimate suggests that the informal economy in Europe ranges from 7.1% of private sector employment in Germany to 27.3% in Poland, reaching 9.1% in the UK (Williams *et al.*, 2017). Informal work is, however, a much broader phenomenon than informal output, as formally employed workers may have all or part of the key dimensions of their employment (notably their pay and working time) set in informal ways that do not conform to formal regulations.

Darbi, Hall and Knott (2018) accept the position of earlier writers like Castells and Portes (1989) that what we term 'non-compliant informality' remains integral to the advanced economy: irregular activities of small firms achieve substantial cost cutting for their corporate customers while sparing the latter from the risks of breaching regulations themselves. But Darbi, Hall and Knott (2018) continue to refer to the 'two sectors' of formality and informality as if these were separate entities, and even identify a whole suite of 'atypical' management practices that appear to characterize the latter. This ignores evidence on such a false binary (Williams, 2004, 2006), with the majority of small enterprises in the UK economy displaying varying degrees and dimensions of informality (compliant and non-compliant).

The implication of such hybridity is that firms should not be expected to respond to the NLW and other regulations in wholly informal and unstructured ways. They will have their own ways of behaving, which may be well entrenched, and can-

not entirely ignore the regulatory environment in which they operate. But there will be a process of adjustment in which informality is important (Ram and Edwards, 2003). It is the 'relative indeterminacy of rules that provides scope for their necessary adaptation in the process of implementation to suit practical circumstances and local contexts' (Picciotto, 2002: 9). Battisti and Deakins (2018) make a similar point in their study of the tax compliance behaviour of small business owners. Firm owners may adhere to the letter and spirit of regulations, or they can find ways of adapting to the rules without complying with their objectives (Braithwaite, 2002: 4).

As for the origins of informality, some stress the structural disadvantages that push firms to cut costs (Castells and Portes, 1989), whilst others locate the problem in the mere existence of state regulations (De Soto and Taylor, 2011). Williams (2004, 2014) sees both perspectives as reductionist: non-compliant informality arises out of a multiplicity of causal forces, ranging from structural disadvantage to various benign motivations such as 'paid favours' for neighbours and kin. Such multiple causes mean that informality, far from naturally receding in concomitance with modernization, can also expand, as with the emergence of new informal and casualized employment practices such as the recent expansion of 'bogus self-employment' (Taylor, 2017). The persistence of non-compliant informality points to powerful forces of inertia. Many small firm owners remain resistant to compliance with official wage regulation; they see themselves as the best judges of what a worker is worth and are often unaware of the increasing likelihood of legal penalties. As De Castro, Khavul and Bruton (2014) stress, non-compliant employers are less concerned with legal regulations than with what their peer group network deems to be 'socially acceptable' (Webb *et al.*, 2009; see also Godfrey, 2011; Kistruck *et al.*, 2015; Siqueira, Webb and Bruton, 2016; Welter, Smallbone and Pobol, 2015). Alongside this there remains a degree of collusion by workers, many of whom continue to treat the security and 'family atmosphere' of the small workplace as compensation for low wages (Jones, Ram and Edwards, 2006; Ram, Edwards and Jones, 2007). Such tendencies are particularly likely in ethnic minority firms, where family and kinship ties are strong. Yet ethnicity is neither necessary nor sufficient for non-compliance to occur (Ram and Edwards, 2003).

Theoretically, the main explanation of the durability of non-compliant informality has come from institutional approaches that have highlighted the cognitive and cultural sources of norms that explain behavioural regularity, or institutional isomorphism, when economic rationality cannot (DiMaggio and Powell, 1991). North (1991) distinguishes between formal and informal institutions, but it is Scott's (2008) identification of three institutional pillars (cognitive, normative and regulative) that has often been applied to non-compliant informality. According to this scheme, informality emerges through tensions between regulative institutions on one side, and cognitive and normative processes on the other; in these cases, behaviour that is illegal in a regulatory sense can be legitimate in a normative one, and regulatory change is interpreted in specific ways often shared by employers and employees, and therefore remains uncontested (Webb *et al.*, 2009). Such an approach has been applied to the informal economy not just in emerging economies, but also in advanced economies such as the UK to explain tax evasion through the 'asymmetry' between 'government morality' and 'societal morality' (Williams and Horodnic, 2016). This approach is relevant to small firms, which often operate in local, demographic and cultural clusters, frequently evade labour law and rely on employee collusion.

Formal and informal institutions are mostly placed at different levels, respectively macro and meso, with the latter being the usual arena of norms, values and beliefs of what is societally acceptable. Yet the meso level is broader and includes industry-level standards, networks and customs, in both product and labour markets (for example, on accountants, IT/financial services or more flexible opening times in restaurants/bars following liberalization).

Kloosterman (2010) shows how market institutions shape the opportunity structure in which small firms operate. While market conditions may be volatile (and therefore not institutions as such), market access, intra-firm and inter-firm coordination follow not just neoclassic market rules but, rather more often, institutionalized rules (Fligstein, 1996). According to Kloosterman, firms are embedded in the three levels of macrosphere (state regulations), mesosphere (market environment) and microsphere (social networks and relationships within firms). As firms are not islands, their internal social relations are themselves

framed by the meso-institutions, such as established social capital networks. A crucial feature of these networks is that they help to generate trust, a vital element in business exchanges built on personal ties rather than legal contracts. Of particular importance is the role of the family and the wider family strategies used to adapt to the 'constraining economic, institutional, and social realities in the larger opportunity structure' (Moen and Wetherington, 1992: 234).

This reasoning is supported by research in the UK (Edwards *et al.*, 2016; Ram, Edwards and Jones, 2007; Ram *et al.*, 2000, 2001) showing that adjacent and ostensibly similar businesses with (compliant and non-compliant) informal practices had multiple interactions with the external economy and institutions. For instance, even a cluster of small businesses that could be perceived as geographically and culturally insulated 'enclaves' framed by specific ethnic/cultural norms displayed a multiplicity of significant relations with business institutions (such as business and consultancy networks) from outside the local community (Ram and Edwards, 2010). A rigid institutional perspective would struggle to account for this multiplicity of normative sources. A broader definition of the mesosphere encompassing both market and cultural institutions accounts more adequately for informality (compliant and non-compliant).

A widely discussed limitation of institutional approaches is how well they can explain change. The field of industrial relations is helpful. Terry (1978), for example, showed that informality was 'inevitable' in large firms in the UK because signals from the external environment were ambiguous and because the norms and rules need constant reinterpretation at the micro level. Regini (1995) dissected the changing ways in which micro-level processes in Italy shaped macro influences; for example, when macro-level formal agreement collapsed (in the 1980s), forms of informal collaboration (which he called 'micro-corporatism') emerged at the meso level in order to keep the economy going. Small firms have similarities: while their internal relations are ultimately based on trust, they are not consensual and conflict-free. The internal dynamics of these firms reflect their ever-changing economic and regulatory contexts.

The lessons from these studies are threefold. First, meso-institutions can explain the continuity of informal arrangements, despite changing regulatory and economic conditions. Second, this

continuity is not homogenous; it varies among firms, reflecting the multiplicity, even within local areas, of meso-institutions. In particular, ethnic networks may coexist with different business networks, and with different sectoral norms. Third, where change occurs, it cannot be explained by the regulatory institutions alone, but must reflect more specific dynamics of incremental change in meso-institutions (e.g. liberalization or cultural/demographic change in ethnic groups) and in micro-level adjustments.

This double research puzzle – the endurance of non-compliant informality and the sources of change affecting meso-institutions and, potentially, transitions to compliance – drives our research questions on how non-compliant firms react to major regulatory change. It also underpins our methodological choice of longitudinal and embedded case studies.

Methods

To examine how managers of non-compliant firms handle regulatory change, we adopt a qualitative case study research design comprising interviews with 22 business owners, together with a worker in each enterprise. The study was conducted in Birmingham (the UK's second largest city), between 2016 and 2017. Our sampling strategy is 'purposeful' (Lincoln and Guba, 1985) in that the context for the case studies – in relation to geography, sectors, and communities – is one where the effects of the NLW are likely to be particularly severe. Birmingham faced an increase in its total wage bill of 0.8% as a consequence of the NLW, compared with 0.3% in London (Corlett, 2016). Recent data from the Annual Population Survey (Office for National Statistics, 2017) shows that employment rates for all ethnic groups in Birmingham (52.8%) and the West Midlands (54.9%) region are lower than the national average (63.9%). Birmingham's unemployment rate is well above the national average, at 9% compared to 4.9% for the whole country.

We chose three sectors where the NLW is expected to 'bite': clothing manufacture, retailing and restaurants (Table 1). Clothing is characterized by asymmetric power relations between buyers and manufacturers, widespread non-compliance and weak enforcement of regulations (Hammer and Plugor, 2016). Hospitality (including restaurants) is a low-paying service sector

in which avoidance of statutory wage rates is often noted (Ram *et al.*, 2001). Retailing is another classic low-paying sector, in which many ethnic minority and migrant communities operate as owners and workers (Ram, Edwards and Jones, 2007).

We focus on firms that are run by ethnic minority and migrant communities because informal economic activity is reputed to be widespread in such enterprises, and because these are the cases of non-compliant informality that tend to be explained by a narrow set of normative institutions (Darbi, Hall and Knott, 2018). As Table 1 demonstrates, the firms are owned by established ethnic minority communities as well as new migrant groups (notably Somalis). The role of family members, either as employees or unofficial 'helpers', was also a feature of the sample (see Table 2).

Fifteen of the 22 firms were investigated in previous work. The study therefore has a longitudinal dimension which allows us to examine whether firms escape the realms of the 'informal economy'. The owners, in all but one case, were re-interviewed. The remaining seven firms were chosen purposefully to add diversity to the sample, and better answer the question on the kinds of meso-institutions that are relevant for non-compliance; for example, our three supermarkets are significant multisite firms, quite different in character to the small localized shops where one might expect non-compliant informality.

DodgeCo, SajCo and SweatCo have been interviewed on at least two separate occasions in previous studies. The other 12 longitudinal cases (LO1 to LO12) were chosen from a study of the practices of recently arrived migrant employers and their workers conducted in 2010 (Edwards *et al.*, 2016). That study examined 49 business owners and 60 workers. Given the focus on non-compliance in the present research, we chose to examine 12 firms that failed to pay the statutory minimum wage in 2010. The interviews with business owners revealed that three firms (LO5, LO6 and LO9) were now complying with the NLW, which allows us to examine the processes that facilitated this transition.

The research design was subject to the university's peer-reviewed ethical review procedure. Nonetheless, securing access to undertake sensitive research (Lee, 1993) is challenging. We used three individuals, each with their own contacts, to conduct the interviews. They included a member of the research team and two freelance researchers with experience of working with the university. This is

Table 1. Market and workforce characteristics of firms

Firm	Sector	Market position	Year established	Employees in 2017	Ethnic origin of owner	NLW status in 2017	Previously researched
LO1	Retail (food)	Growing (struggling in 2010)	2005	25 (15 full-time and 10 part-time)	Somali	Non-compliant	2009
LO2	Retail (clothes)	Struggling (struggling in 2010)	2005	3	Somali	Non-compliant	2009
LO3	Retail (food)	Growing (stable in 2010)	2006	4	Somali	Non-compliant	2009
LO4	Retail and money transfer	Struggling (struggling in 2010)	2006	4	Somali	Non-compliant	2009
LO5	Retail (food)	Growing (stable in 2010)	2005	4	Somali	Compliant	2009
LO6	Retail and money transfer	Growing (stable in 2010)	2006	4 employees and 3 helpers	Somali	Compliant	2009
LO7	Retail (IT)	Stable (stable in 2010)	2006	2 employees and 2 helpers	Somali	Non-compliant	2009
LO8	Retail (IT)	Stable (stable in 2010)	2006	2 employees and 2 helpers	Somali	Non-compliant	2009
LO9	Retail (food) and restaurant	Growing (growing in 2010)	2005	13 employees (7 full-time, 3 part-time and 3 casual)	Somali	Compliant	2009
LO10	Retail (food)	Stable (growing in 2010)	2005	6 (4 full-time and 2 part-time)	Somali	Non-compliant	2009
LO11	Retail (food and clothes)	Stable (struggling in 2010)	2009	1 FT	Somali	Non-compliant	2009
LO12	Restaurant	Growing (growing in 2010)	2006	Over 100	Iranian	Non-compliant (previously non-compliant)	2009
SajCo	Restaurant	Struggling (growing in 2010)	1970	6	Indian	Compliant	1998, 2004
BalCo	Clothing manufacture	Stable	1985	7	Indian	Non-compliant	
HaCo	Restaurant	Struggling	1998	12	Indian	Non-compliant	
CromCo	Restaurant	Stable	2005	6	Nepalese	Non-compliant	
DodgeCo	Clothing manufacture	Struggling (growing in 2004)	1980	2	Indian	Non-compliant	1999, 2004
SweatCo	Clothing manufacture	Struggling (growing in 2004)	1982	10	Indian	Non-compliant	1999, 2004
ItCo	Restaurant	Stable	2002	20	Indian	Non-compliant	
Supmkt 1	Supermarket	Growing	1992	20	Pakistani	Non-compliant	
Supmkt 2	Supermarket	Growing	1985	50–60	Pakistani	Non-compliant	
Supmkt 3	Supermarket	Growing	2000	N/A	Pakistani	Non-compliant	

a form of ‘chain referral sampling’ (Penrod *et al.*, 2003), an approach that draws respondents from a variety of networks rather than just one (as in the case of snowball sampling). Qualitative interviews were conducted with the owner and a worker

in each firm, amounting to 44 interviews. The interviews established the competitive position of the firm and examined the impact of the NLW on relationships in the enterprise. The networks that owners drew on for guidance on the NLW and

Table 2. Family and non-family workers in firms

Business	Sector	Family employees	Family helpers	Non-family employees	Non-family helpers
LO1	Retail (food)	YES	NO	YES	YES
LO2	Retail (clothes)	NO	YES	YES	YES
LO3	Retail (food)	NO	YES	YES	YES
LO4	Retail and money transfer	NO	YES	YES	YES
LO5	Retail (food)	NO	NO	YES	YES
LO6	Retail and money transfer	NO	NO	YES	YES
LO7	Retail (IT)	NO	YES	YES	YES
LO8	Retail (IT)	NO	YES	YES	YES
LO9	Retail (food) and restaurant	NO	YES	YES	YES
LO10	Retail (food)	NO	YES	YES	YES
LO11	Retail (food and clothes)	NO	YES	YES	YES
LO12	Restaurant	YES	YES	YES	YES
SajCo	Restaurant	YES	YES	YES	YES
DodgeCo	Clothing manufacture	NO	YES	NO	YES
SweatCo	Clothing manufacture	YES	YES	YES	YES
BalCo	Clothing manufacture	YES	YES	NO	YES
HaCo	Restaurant	YES	YES	YES	YES
CromCo	Restaurant	NO	YES	NO	YES
ItCo	Restaurant	YES	YES	YES	YES
Supmkt 1	Supermarket	YES	YES	YES	YES
Supmkt 2	Supermarket	YES	YES	YES	YES
Supmkt 3	Supermarket	YES	YES	YES	YES

other regulations were also investigated. Workers were interviewed to obtain a complementary perspective on the impact of the NLW on working practices.

Data analysis followed a ‘circular-spiral pattern’ (Schwartz-Shea and Yanow, 2012: 28) by moving iteratively between the 44 accounts provided by the respondents, themes and theoretical ideas to reconcile discrepancies and synthesize these themes (Verver and Koning, 2017). We followed a four-stage procedure, informed by Gioia, Corley and Hamilton (2013). First, we read and re-read transcripts independently to gain detailed insights of individual accounts of the 22 firms. Next, by applying our conceptualization to the accounts, we discussed and broadly coded *a priori* themes: from non-compliance to compliance and persistent non-compliers. At the third stage, we immersed ourselves in the raw data in order to interrogate and reach agreement on the central subthemes: ‘struggling to survive’, ‘comfortable in their current position’ and ‘pursuing strategies of growth’. Finally, the research team reflected further on the research themes, moving holistically from the raw data, in order to develop a coherent and overarching understanding (Corley and Gioia, 2004) of how non-compliant firms react to major regulatory change. We asked an experienced qualitative researcher (not directly involved with the project) to assess

our approach. She reviewed our interview schedules, a random selection of transcripts and approach to data analysis in order to assess the plausibility of our conclusions.

Findings: Non-compliant firms in motion

From non-compliance to compliance

The powerful role ascribed to meso-institutions in accounting for non-compliance emphasizes the enduring nature of values and norms. Our findings suggest that they can come under strain when workers become aware of their worth and power in the labour market, which is clearly an effect of regulation. This was evident in the case of the four firms (SajCo, LO5, LO6 and LO9) that had become compliant with the NLW since they were last studied. SajCo, an upmarket centrally located curry house, accommodated previous minimum wage legislation by adopting a ‘business as usual’ approach; that is, workers accepted cash-in-hand payments in exchange for a relaxed, ‘give-and-take’ work environment. This changed abruptly in 2008 with an employee’s complaint to the tax authorities about underpayment; it was a violation of the accepted code, and led to a new system of written employment contracts

guaranteeing the National Minimum Wage (the precursor to the NLW) to all workers. The norms of loyalty and trust had been disrupted, leading to a more instrumental approach by management. In the owner's view this inflated labour costs: 'You can pay someone £7.50 an hour if they're worth it but if they can't even pick up a plate you're still paying them'. It also undermined loyalty: 'It might take a couple of months to train them ... but once you've taught them they bugger off'.

At the macro level, the worker's attempt to claim his formal entitlements was an effect of formal regulation. With regard to the market, compliance occurred not as a result of improved trading conditions but, counterintuitively, during a period of deterioration with new competitors emerging in their inner city niche. As for the state, compliance took place not from fear of the regulator (who had actually given SajCo a clean bill of health), but because of a change in the meso level, which manifested itself as a breach of the unwritten code of the workplace.

Unlike SajCo, other newly compliant firms – LO5, LO6 and LO9 – had grown. LO5 diversified his food retail and money transfer business by importing ethnic clothing and perfume. LO6 introduced a 'fast food' outlet to complement his Internet café business. LO9 now comprises a restaurant, take-away and the retailing of exotic imported foodstuffs. It also has three other branches around the UK. Yet dynamics within the firm, rather than business growth or the NLW, were the triggers for compliance:

Our internal restructuring strategy has got nothing to do with NLW. We complied [because of] our model of putting customers at the centre of our business ... I think that is what makes our rates so attractive. (LO9)

Compliance for LO5 was a gradual affair, prompted by a desire to be customer-centric. A further factor was the need to retain two key workers who threatened to leave the firm unless they were paid the NLW. There was pressure from within the workplace microsphere, a factor also recognized by LO6: 'our employees might quit our business for better paying businesses elsewhere if we don't pay them minimum wage' (LO6, 2017 interview). The loyalty of these 'star' employees was clearly diminishing, which eventually led to the move to compliance. LO9's decision to comply was the product of 'long and hard thought' and 'advice from many

business colleagues as well as from our business advisor'. But the switch to compliance was neither total nor permanent. Disposable cash-in-hand workers (or 'or the continued to be used as a buffer against trade fluctuations. LO5 has 'reduced the number of helpers' but continues to 'rely on them when we have shortage of staff'.

The adopters of the NLW highlight the importance of the three levels in our institutional perspective. Workers were aware of the changes at the macro level, which in turn exposed weaknesses in the meso-level institutional environment. In the case of SajCo's complainant, it showed that the firm had employees who did not believe or adopt norms of loyalty. The cases that adopted the NLW to retain key workers tell a similar story: their star employees had less fealty to traditional norms of loyalty. Importantly, the position of employees in the firms was also salient: they were skilled and valued workers.

Persistent non-compliers

This category is characterized by longstanding non-compliance and a disinclination to change. But stylized views of 'atypical' management practices, 'under the radar' operations and limited ambitions are confounded by our findings. We find considerable heterogeneity and classify our firms as: struggling to survive; comfortable in their current position; and pursuing strategies of growth. A variety of meso-level institutions influenced the varied responses of these non-compliers. The formal, macro-level regulatory environment is largely seen as tangential. Competitive conditions, determined by changing economic institutions such as product market standards and international trade regimes, are important in shaping responses to regulatory pressure, alongside normative and cognitive meso-level institutions, such as family and community norms framing labour supply. We consider their influence in each category of firm.

Struggling to survive: Trapped by the market

Only three firms – LO2, LO4 and LO11 – resemble the image of the marginalized and exploitative operator. With a gross turnover of less than £10,000 p.a. in 2010, LO2 is a marginal operation, one of the rare cases where non-compliance with NLW is a virtual necessity for survival. As the owner explains: 'We pay them below the NLW because

the business is not generating enough profit' and any pay rises are determined by the firm's earnings. LO2's worker confirms the lack of voice and bargaining power: 'We take what the employer offers ... I am not satisfied at all with the level of pay, but there's nothing you can do' (LO2 worker). LO4 and LO11 also struggle. LO11 complains of excessive competition, a problem aggravated by economic recession: 'many of our regular customers have been made redundant and don't regularly buy goods from our shop as they used to'. Like LO2, the owner worries about Brexit: 'the majority of our customers are EU nationals such as Dutch, Italian, Spanish, Danish'. Poor revenues are again used to justify non-compliance.

Comfortable non-compliers: Keeping it in the family

The eight 'comfortable non-compliers' (LO7, LO8, HaCo, CromCo, SweatCo, DodgeCo, BalCo, ItCo) are content with their trading position and have no intention of observing the NLW. The opportunity structure was difficult, with most owners complaining of competition and experiencing long-term decline. The role of the family, along with the absence of workforce pressures, was crucial in accommodating regulatory pressures.

HaCo and CromCo, both well-established mid-range restaurants, operate in contrasting locations and target different clientele: the latter nestles in a semi-rural village with a loyal local customer base, whilst the former taps into the busy footfall of central Birmingham. Crucially, both rely on family members to manage and sustain the business, as CromCo's owner explains: 'My wife and son don't have set salaries ... This is our livelihood, they can't expect a salary otherwise there wouldn't be a business'. During peak periods, other family members and friends provide casual help, and 'they get paid for the day or week'.

A similar absence of employee pressure is enjoyed by HaCo, where the owner's 'brother is the cook, cousin is in charge of operations and nephew is in charge of waiters'. The consequent low labour costs, bolstered by 'using helpers, under-recording of hours, no contracts' is crucial to staving off competition: 'previously we were the "go to" place in the area if people didn't want fish and chips, now you can pick 10 different things'.

Similarly suffering hypercompetition is ItCo, but here entrepreneurial initiative has created a

qualitatively different niche – customers prepared to pay premium prices for distinctive cuisine: '[In the city centre] we can attract the city folk who are happy to pay more' (owner, ItCo). Family members occupy management roles and 'are not afraid to get their hands dirty in cleaning and waiter work'. ItCo also benefits from a worker who was a first-generation migrant from India. Lacking the aspirations of the discontented workers described earlier, he received cash in hand for a 45-hour week but claimed to be 'comfortable with this at the moment' and believed he is unlikely to 'earn the same' elsewhere.

Social relationships in the three clothing firms – BalCo, DodgeCo and SweatCo – were shaped by the wider family context of the firms' owners. We have investigated DodgeCo and SweatCo over a 20-year period, and one of the research team has known BalCo's owner and family as long. These firms have suffered prolonged decline, but the owners are from affluent households and each has decided to invest family resources into other ventures rather than their clothing firms. Starting in the mid-1980s, clothing wholesaler DodgeCo's fortunes have waxed and waned. The 1980s were profitable, with staff numbers growing from 1 to 10, turnover doubling in a matter of a few years and a diversification into retail. However, intense competition in the 1990s precipitated major retrenchment, leaving one part-time and one full-time worker in 2004. This tiny labour force remained the same in 2017. Surviving by offering cut-price clothing to market traders, the firm also cut costs by employing low-aspirant migrant casual workers for peak periods: 'If we have a big container coming in, we'll find an immigrant and pay him £10–15 to unload 100 boxes'. Sensing further decline, the owner and his spouse have, since 2004, developed a property portfolio rather than investing in the clothing business.

SweatCo is a family-run business that first opened in the early 1970s. The owner's brother, sister, brother-in-law and cousin were amongst the firm's 10 employees (down from 50 in 2000). This sharp reduction was attributed to foreign competition, which prompted a switch from clothing manufacture to importing. As the owner of this third-generation family business remarked: 'the advantages [of family] are you trust them'. But succession is an issue because the proprietor's children were pursuing their own careers and only helped out on an ad hoc basis. He, like DodgeCo's owner,

was investing in property and is likely to wind down SweatCo in the next 5 years.

BalCo is a third-generation family business run by the owner and his two sons. Gloomy prospects for clothing manufacture prompted the owner to start two new (and compliant) businesses in unrelated sectors. Manual work at Balco was undertaken by recent migrants because: ‘immigrants ... have a good attitude, they’re here for the money’. The firm operated in a shrinking market dominated by small local and national firms. Coping strategies included the use of cheap migrant labour and family control of management and technical positions like social media and diversification

Growth-oriented non-compliers: Colluding to grow

Many firms achieved remarkable levels of growth outside formal institutions. Outstanding here is LO1, which developed from a struggling supermarket in 2010 to a thriving concern, with a butcher’s shop operation and recently acquired restaurant added to the premises. The owner explained his varied portfolio:

Customers who come to the supermarket will go to the butcher ..., send money abroad through our money transfer ... It is all connected ... and if you are hungry ... the restaurant is next door. (LO1)

Significant expansion was also a feature of Supmkt 2, a company that had six branches in different UK cities with plans for further acquisitions. Despite intense competition, Supmkt 2’s longevity, loyal customer base and purchasing power allowed them to undercut their rivals.

A number of factors explain how these firms achieved significant growth whilst remaining inconspicuous to the authorities. First, family members occupied key positions, particularly in the larger multisite supermarkets. Family members in Supmkt 3 were responsible for all management functions, which ensured ‘flexibility ... commitment ... and ... long term benefits to the family’. For LO10, family members ‘have a duty to ... work for the greater good of the family, without expecting payment’.

Second, non-family employees, accountants and advisers colluded to facilitate non-compliance. In what seems a smokescreen for questionable practices, Supmkt 2’s holding company sets pay for the various branches:

Rates of pay are determined by the management of the [holding company] after a recommendation from the body ... with the responsibility of looking pay rates ... Management thinks if we comply with NLW we will lose jobs.

This widespread tendency of non-compliant firms to seek external expertise from accountants and external advisors is noteworthy. LO1 – ‘comfortable with ... informal advice’ in 2010 – now looked to his accountant to guide him on the NLW and other issues. The owner relied on friends and family in 2010 because of his unfamiliarity with the UK business environment. In 2017, he used accountants because ‘as the business grows, you need to show ... good practice’. It appears that they are being used to sustain non-compliance rather than ensure regulatory conformance.

Third, the veneer of formality is facilitated by selective compliance: full-time workers were now paid the NLW, but less well-remunerated helpers remained integral to the firms.

[Helpers] are important because they can help carrying/loading the fresh fruits/groceries pallets day in day out, ... Employees ... are paid either weekly or monthly, whilst helpers ... are paid [on the day]. (LO1)

Nonetheless, awareness of the NLW amongst some key workers put a strain on the business. Citing the example of three recent recruits, LO1 complained:

We trained them in hygiene, health and safety and they got certificates. However, they [soon] left to work for another business with better pay and conditions. (LO1)

The owner also felt that regulations forced him to pay decent wages to undeserving workers: ‘Some ... don’t have basic customer care skills and attitudes and we had to sack them to maintain [our] reputation’.

If owners like these are to comply, pressures are likely to come from the workplace as much as the regulatory macrosphere. Despite recent moves by the state to crack down on non-compliers, owners seem oblivious to the threat. They are more likely to feel pressured internally because the traditional workplace, populated by easily satisfied first-generation migrants, is dwindling. Hence there is a rising sense of dissatisfaction among the present cohort of workers, as exemplified by

Meena, an assistant manager at Supmkt 2, who worked a 50-hour week:

I am not satisfied with my pay [£7.40 per hour] due to the rising cost of living. My salary is not reflected in my duties ... I have a young family ... [I]t's not enough at all to make ends meet.

Employee discontent is evident in other firms too, and most complained of a lack of influence over pay and working conditions. Many workers felt resigned to their fate. LO12's worker, who was paid below the NLW, explains:

Our pay has remained the same for several years; only the manager can increase our pay ... Pay increases are not awarded fairly ... Employees don't have any influence.

Discussion

Our research aimed to explore how managers of non-compliant firms respond to major regulatory change, notably the NLW. The institutional asymmetry perspective associated with Webb *et al.* (2009) has advanced management scholarship by highlighting the importance of informal institutions, but the dynamics of actually managing non-compliant firms remain elusive (Darbi, Hall and Knott, 2018). Our cases, focusing on 'non-compliant informality', appear to be suggestive of homogeneity since they operate in low-paying sectors where non-compliant informality is particularly prevalent, are located in a geographically discrete area, and are owned and staffed by ethnic minority groups. But we find a considerable variety of practice, a fluid relationship between formal and informal institutions, and tensions within firms. That such a finding is surprising within the domains of 'mainstream' management and entrepreneurship studies is perhaps an indication of their closeness to economics. Godfrey (2016) believes that such a link reflects management scholarship's conflation of formality with progress, whilst Baker and Welter (2018) see a connection between economists' domination of the entrepreneurship domain and their lingering preoccupation with the innovative and job-creation potential of a narrow band of rapid-growth 'gazelles'. Drawing on rich empirical evidence informed by economic and industrial sociology (Castells and Portes, 1989; Edwards *et al.*, 2006; Ram and Edwards, 2003,

2010), we advance management scholarship on the informal economy in two ways. First, we include the institutional market environment and wider opportunity structures (Kloosterman, 2010) within the range of meso-institutions that influence the informal economy. Importantly, firm sector shapes the scope for informality (compliant and non-compliant), as well as determining the overall conditions faced by the firm (Arrowsmith *et al.*, 2003). Second, we demonstrate that micro-level analysis needs attention too, because social relations within the firm mediate the effects of external influences. Small firms are not wholly insulated from external influences (Edwards *et al.*, 2006). This integrated approach views context as multilayered and influenced by the cognitions and actions of entrepreneurs and the people with whom they interact (Baker and Welter, 2018: 386).

The various elements of our integrated institutional perspective help to explain how managers responded to economic and regulatory change. First, the tough trading environment generated pressures to contain costs and limited managers' capacity to absorb the expense of regulatory compliance. Restaurateurs and retailers made repeated reference to the 'cut-throat' nature of the competition and 'trying to outdo one another'. Survival for clothing employers relied on price-cutting, sourcing cheap imports and a retreat from manufacturing. The significance of this approach is that the impact of regulations will be felt differently in different competitive circumstances, hence the theoretical importance of encompassing the product market in assessments of meso-level institutions.

Second, at the meso level, a source of labour based on community, family and kinship ties allows managers to compete. Workers' reluctance to challenge non-compliant employers is shaped by the paternalistic bargain, which is rooted in familial and community links. Workers' acceptance of the situation is not solely a matter of exploitation and silent resentment. Some workers appreciate the opportunities they have, while others are aware of the financial pressures facing firms. There is thus acceptance and accommodation rather than overt resistance. But employers also 'get away' with non-compliance because of the dependency, vulnerability and liminality of certain employees. The latter are the outcome of wider historical and geopolitical forces, rather than unrestrained managerial agency. There also continues to be a

supply of labour, of illegal or undocumented workers, and such supply may become increasingly important if the pool of legal migrant labour is restricted after Brexit. But new generations, and migrant workers after settling, can become more proactive and assertive in their wage demands, in knowledge of their rights and in their capacity to use the ‘exit’ strategy to force employers into paying higher rates.

Non-compliant firms survive, and sometimes grow, with the support of formal regulatory agents like accountants and business advisers. Small business owners, particularly migrant firms of the kind reported on here (Ram and Edwards, 2010), tend to eschew formal sources of business support. The widespread tendency of firms to seek external expertise in the present study is therefore surprising. Accountants appear to be facilitating non-compliance: ‘We are not the only one that are not complying ... Our accountants are also aware of our non-compliance’ (LO4). The influence of accountants and other professional accomplices helps to explain why non-compliant entrepreneurs in mature economies are ‘willing to incur the legal risk and how they are able to grow ventures outside of formal institutions’ (Webb, Ireland and Ketchen, 2014: 8). It appears that these professionals are instrumental in helping managers to decide the ‘optimal’ degree of formality and navigate the intricacies of formal institutions (Skousen and Mahoney, 2016).

A number of wider implications can be identified, which include the value of industrial sociology, the ‘impact’ of regulations and the link between managerial agency and the employment relationship. A key contribution is the value of an industrial sociology perspective to the enrichment of institutional approaches to the informal economy. Although institutional theory offers a ‘common language’ for scholars, greater ‘interdisciplinary efforts [are] needed to tackle the sort of complex issues posed by the informal economy’ (Ketchen *et al.*, 2014: 97). Industrial sociology is helpful in explaining the mechanisms that (re)produce informality, particularly in its insistence on sector and business networks as key meso-level institutions. Sociologically informed analysis draws attention to sectoral norms; the often local and highly specific character of the markets engaged by small firms (compliant and non-compliant) and the ‘entrepreneurial effect’ of different levels of management expertise,

experience, strategies and access to capital (Arrowsmith *et al.*, 2003). These factors combine to shape responses to regulatory change and demonstrate the ‘confluence of formal and informal institutions’ (Webb and Ireland, 2016: 32). Our study of long-term non-compliance and, in some cases, transitions to compliance is grounded in the sociological tradition. Its contribution is to provide a more longitudinal perspective on the complex and dynamic relationships between institutional factors and informality. It provides a granular picture of the mechanisms in action by adopting a perspective that has the potential to enrich prevailing institutional approaches.

Our perspective also informs debates on the ‘impact’ of regulations on non-compliant firms. Sociologically based studies (Edwards, Ram and Black, 2002; Edwards *et al.*, 2002; Kitching, 2016; Ram, Edwards and Jones, 2007) question the notion of a direct effect of regulations, and suggest that outcomes vary over time, are dependent on social relationships within the firm and are shaped by external stakeholders (Kitching, 2016). Our longitudinal analysis shows these processes at work. Non-compliant employers’ discovery of regulations was shaped by social interactions with external networks. The surprisingly prevalent use of accountants and business advisers casts light on how non-compliers learnt about regulations, and in many cases developed strategies to evade them. The latter point is important in understanding how ‘successful’ (large or growing) non-compliant firms handle institutional pluralism or ‘polycentricity’ (that is, simultaneous engagement in multiple institutional domains; see Webb and Ireland, 2016). Some (De Castro, Khavul and Bruton, 2014; Ketchen *et al.*, 2014) see the greater engagement with macro-institutions as firms become successful as a challenge to their embeddedness in meso-institutions; our study suggests that such institutional pluralism can be compatible and mutually reinforcing. The pattern of social relations (or implicit bargaining) within the firm and with key business networks is of central importance in handling the potentially competing ‘logics’ of different institutional domains. When social relations are disrupted – as we saw with SajCo and the threat of some skilled workers leaving the firm – regulatory change is likely to be more keenly felt.

The importance of temporally sensitive analysis to assessing the ‘impact’ of regulations is also

evident. Speculation abounds on the permanence of the informal economy and its susceptibility to regulatory change (De Castro, Khavul and Bruton, 2014; Welter *et al.*, 2015). Too often: ‘studies ... ignore the temporal specificity of regulatory burdens, implicitly treating them as invariant over time’ (Kitching, 2016: 603). Time matters, and longitudinal analysis is needed to grasp the complex and contextually specific dynamics of formalization and/or continued non-compliance.

Finally, we develop the link between managerial agency and the employment relationship. We have drawn attention to the central role that social relations between owners and workers play in shaping responses to regulatory change. Influences from macro and meso-level institutions were mediated by the structures and traditions of the workplace. Institutional approaches emphasize ‘informal adjustments’ (Godfrey, 2016; Webb and Ireland, 2016), but regard this as ‘norms, values, and beliefs [that] become the basis for collectively shared rules’ (Webb and Ireland, 2016: 23) rather than the trade-offs that characterize competing interests in the workplace (Edwards *et al.*, 2006). Three points are worth emphasizing.

First, it is important to recognize familial and other networks in which non-compliant firms are often embedded. As we saw in a number of cases, managerial agency could only be understood as part of an overarching ‘household’ strategy that encompassed a range of diverse activities outside the confines of the non-compliant firm. Within the firm, family members tend to occupy managerial positions, which facilitates non-compliant activity. Familial relations provided an important source of flexibility for workers and managers, and shaped approaches to organizational practices such as recruitment and management of the enterprise.

Second, the internal inequalities and abuses we uncovered caution against an uncomplicated link between meso-institutions and notions of shared norms. Managers in non-compliant firms often exploit personal relationships and networks of vulnerable workers. This can create a situation of indebtedness and resignation rather than workplace harmony. The sociological concept of competing interests – elicited by incorporating workers’ voices – guards against the unitarist portrayal of meso-level actors and institutions. It aids the goal of contextualization by recognizing the ‘dynamics of power, domination, oppression, inequality and

violence’ (Baker and Welter, 2018: 401) often neglected in extant studies.

Third, we show that workers are not passive recipients of managerial control even in firms in which owners have seemingly little constraint on their prerogative. Owners faced the contradictory pressures of a competitive and price-sensitive market, a restricted pool of labour and reliance on highly skilled workers. The NLW helped some workers to take advantage of this set of circumstances (which are again illuminated by sociological analysis).

Conclusions

Managers of non-compliant firms are emboldened by the absence of effective external deterrence from the state. Despite the state’s enhanced rhetorical commitment to enforcement, the risks of being penalized are low. There is a gap between the enactment of regulations and their practical enforcement. Not only can enforcement be difficult, with government agencies struggling to plug loopholes, but the will to enforce may itself be weak or non-existent. This could be due to passive bystanding, or tacit encouragement (since informal economic activity can be viewed as a means of generating employment and self-employment among otherwise socially excluded sections of the population, often in decaying urban areas).

At least three approaches can be suggested in relation to firms of the kind reported here. First, attack the cases of clear exploitation, as they tend to be deemed illegitimate even by informal normative meso-institutions – the asymmetry is therefore narrower. Second, identify and support firms which are actively seeking formalization (like those that have moved into compliance in our sample) by strengthening those meso-institutions (e.g. local employer associations) that can support both compliance and business survival. Third, provide forms of labour empowerment (through mechanisms of voice, better employment security and employment advice centres) that can support employees in claiming their rights. These approaches are ambitious given the durability of the informal economic activity in the UK, but not impossible given the occurrence (albeit rare) of transition to formality and the potential for changing a set of meso, normative institutions that are far less homogenous and intractable than often assumed.

Our theoretical and empirical insights can be developed further in two ways. First, the particular dimension along which firms in the economy vary can be calibrated more precisely. We have identified some influences (for example, product and labour markets), but this can be added to, perhaps drawing on the models of Darbi, Hall and Knott (2018) and Edwards *et al.* (2006). They could also lend themselves to quantitative research, measuring influences like the degree of family control. Second, extending this line of research to non-migrant firms beyond the 'ethnic economy' would widen the applicability of the approach we have adopted.

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Supporting Information

Additional supporting information may be found online in the Supporting Information section at the end of the article.

Supporting Information
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