



SHADOW/INFORMAL ENTREPRENEURSHIP in RUSSIA: SOME CONSIDERATIONS

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PROPOSED APPROACH

- Shadow (= grey, informal) economy \neq black (=illegal, criminal) economy: Illegal activity – something not only hidden but **criminal, forbidden** by law
- Informal economy $>$ informal entrepreneurial activity
- Informal entrepreneurial activity $>$ informal entrepreneurship
- Roots of informal entrepreneurial activity in post-Socialist economies and societies – partly in the ‘common past’, but mainly – in (differing) transitional contexts

INFORMAL ENTREPRENEURIAL ACTIVITIES: definition

- **Informal entrepreneurial activities** (narrow definition): unreported or in other ways hidden from the state activities of formally legal, registered entrepreneurs/entrepreneurial firms
- Their business is not “antisocial in intent” (De Soto 1989) and they produce goods and services that are not forbidden by law
- Informal = shadow = grey

INFORMAL ECONOMY ≠ INFORMAL ENTREPRENEURIAL ACTIVITIES

- Informal employees working informally for businesses being mostly or entirely informal
- Informal hiring by micro entrepreneurs (on start-up stage to test the business feasibility while minimizing transaction costs)
- Informal hiring by more established business (part of 'getting by' strategy in a serial manner)
- Informal financing of businesses
- Free-lancers occasionally hiring employees on informal basis
- Informal work by family, friends, and acquaintances (partly substituting formerly reciprocal relations)
- Only **actors marked red** are actively doing informal/shadow/grey entrepreneurial activities

MAIN FORMS OF INFORMAL ENTREPRENEURIAL ACTIVITIES

- Off-the-books-transactions with **providers** and **customers**
- Hiring of **employees** without written contract
- Informal **financing** of business (3 F)

4 theoretical explanations of informal entrepreneurship under transition (C. Williams)

- **Modernization perspective:** “under-development,” “backwardness” and “traditionalism” (very general observations to be discussed in brief – concept of **LAO** could help to formulate it in a more concrete way),
- **Structuralist perspective:** informal entrepreneurs are unwilling and unfortunate pawns in an exploitative global economic system, cast out into the informal economy because of their inability to find formal work (lack of skills, **necessity driven** entrepreneurs)
- **Neo-liberal perspective:** direct response to the over-regulation of the market (avoiding **administrative burdens**),
- **Post-structuralist perspective:** an alternative space in which participants transform their work identity and/or reveal their true selves such as by establishing informal lifestyle businesses (down-shifters and **free-lancers** becoming entrepreneurs)
- In fact, all of these reasons play important role in sustainable persistence of informal entrepreneurial activity in Russia, influencing a *variety of motivations and strategies* of informal entrepreneurial activity on individual level

REASONS OF INFORMAL ENTREPRENEURIAL ACTIVITIES IN TRANSITIONAL ECONOMIES like RUSSIA

- **‘Path dependency’ (mentality):** high power distance, subsistence economy & neighborhoods’ help tradition, tolerance against tax evasion etc., relying more on shared norms than on legal framework → higher inclination to act informally among adult population
- **Macro-economic reasons:** after opening of internal markets, micro and small business mainly competitive only in B2C services (repair, construction, furnishing etc.) which are often very informally by its nature → rational strategy of avoiding unfair competition
- **Labor market reasons:** structural unemployment etc. (‘shuttle traders’), since the end of the 90ies of minor importance
- **Financial reasons:** high level of inflation, weak (micro)financial institutions → lending and borrowing money informally (more expensive but quick)
- **Societal reasons:** corruption as a medium to avoid unnecessary interventions and obstacles from authorities → informal entrepreneurship both result and precondition of embedded corruption
- **State interventions:** fiscal oppression leads to higher level of informality (example: 2013, minus 700 000 solo entrepreneurs)

WHEN INFORMAL ENTREPRENEURIAL ACTIVITY BECOMES A PREDICTED RATIONAL BEHAVIOUR?

	Formal	Informal
Main risks	Commercial, political	Only commercial
Property rights	Defined formally, enforcement by State	Defined informally, enforcement by 'roof'
Competition	High and open	Hidden, therefore may be low or high
Remaining income	Income minus amortisation minus taxes	Income minus amortisation minus bribes

TYPES OF ENTREPRENEURS, BY LEVEL OF FORMALIZATION AND MOTIVATION: TARGET GROUPS MARKED RED

	Mostly formally acting	Mostly informally acting
Mostly necessity driven	‘Fools’ (having limited resources but acting according to rules)	‘Marginals’ (coping with limited resources by avoiding of regulations)
Mostly opportunity driven	‘Stars’ (having sufficient resources and skills, heavily personally-driven)	‘Cynics’ (using the informality as additional advantage when reducing costs)

INFORMAL ENTREPRENEURSHIP AND ENTREPRENEURIAL ACTIVITY OF POPULATION

According to *Estrin & Mickiewicz* (2012, p. 575):

- “the likelihood of entrepreneurial entry in general, and on the likelihood of entry into high growth aspiration activities ... decreases as the shadow economy becomes larger, at least up a certain point”;
- “the negative effect of a larger shadow economy may be reversed when the informal sector has a large share of GDP... when the shadow economy is sufficiently large, it becomes institutionally embedded. In consequence, a set of functional norms for economic transactions is generated, which provide an **alternative order for economic organization**”.
- Russia is a country with a relatively large shadow economy (=informal sector), see next slide...

DIVERSITY OF INFORMAL *ENTREPRENEURIAL* ACTIVITIES IN RUSSIA

- Established entrepreneurs conducting **some of their transactions informally** (expert estimations: 25 to 40 % of reported economic activities)
- Start-ups as spin-off from **formal** and **informal** labor market **toward legitimacy** (ca. 5 % of adult population; Gimpelson & Zudina)
- **'Silent lenders'** engaged into informal financing of entrepreneurs (ca. 2 % of adult population; GEM Russia, 2006-2011 data)
- **Free-lancers** becoming employers on temporary basis on informal basis (no data)
- **Occasional** entrepreneurship (business parallel to employment) (driving people and goods occasionally, etc.) (no data)
- Meanwhile...

The early entrepreneurial activity in Russia is stable low (GEM, 2006-2011)

Indicator	2006	2007	2008	2009	2010	2011
TEA, %	4,9	2,7	3,5	3,9	3,9	4,5
NasEnt, %	3,5	1,3	1,7	1,8	2,2	2,4
BBO, %	1,4	1,3	1,8	2,1	1,7	2,2
EBO, %	1,2	1,4	1	2,1	2,7	2,8
TEA OPP, %	3,4	1,9	2,5	2,6	2,5	3
TEA NEC, %	1,4	0,5	0,7	1,1	1,3	1,2
TEAf, %	2,5	1,6	2,5	3,2	3,5	4
TEAm, %	7,3	3,8	4,5	4,6	4,5	5,1
Nas nec, %	0,7	0,4	0,2	0,6	0,7	0,5
BBO nec, %	0,9	0,2	0,7	0,5	0,6	0,7 12
EBO nec, %	0,1	0,2	0,2	0,6	1,2	1,1

Famous 'Russian uniqueness', or ?

- North e.a. (2009): free vs. limited access orders
- We assume that in countries with:
- Limited access order and ...
- ... coexisting types of socio-economic development (Natalia Zubarevich on the 'three Russia's': traditional rural, industrial urban and post-modern in biggest cities)
- informal activities of **start-ups** may be rather intensive (second jobs, subsistence economy, neighbors' cooperation, etc.) but not of *entrepreneurial* nature
- because (1) the entry is either not 'open' or open only for those with *specific* social capital; (2) in big areas there are other possibilities to finance the households than employment or own business given – subsistence economy combined with self-employment, or even black economy (hunting, fishing etc.)
- While **already established SMEs** are hugely engaged in different forms of informal entrepreneurial activities

Challenging questions:

- Should informal entrepreneurial activity in Russia be treated as a danger or as a quite rational behavior under fragile environment ? →
Implications for society and state policy
- Which kind of concepts, paradigms etc. should be used to explain the nature and sustainability of informal entrepreneurial activity in Russia and similar economies and societies?
- Which are the most appropriate research strategies to cope with informal entrepreneurship in Russia (and in some fragile post-transitional environments generally), as typical quantitative methods are hardly reliable?

What is different?

- Contrary to established market economies with FAO where entrepreneurial activities start informally but then move toward more formal activity
- In established markets with LAO the situation might be opposite: the older – the stronger the incentives to become informally (?)



THANK YOU!

Questions, replies,
comments welcomed!!

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