

Shadow Economy's Effects on Entrepreneurial Mindsets and Entrepreneurship Development

Case: Russia

LAHTI UNIVERSITY OF APPLIED
SCIENCES LTD
Faculty of Business and Hospitality
Management
Degree Programme in International
Business
Bachelor's Thesis
Spring 2017
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IVANOVA, ALEKSANDRA: Shadow Economy's Effects on
Entrepreneurial Mindset and
Entrepreneurship.
Case: Russia

Bachelor's Thesis in International Business 144 pages, 7 pages
of appendices

Spring 2017

ABSTRACT

Russian economy today is characterized by slowing pace of economic growth. Economic development is assured by number specific factors. The key ones affecting development of market economy are entrepreneurship development and shadow economy.

The main objective of this research was to investigate relationships and dependencies between entrepreneurial development and shadow economy through shadow economy's effects on entrepreneurial mindsets and to predict entrepreneurial development in Russia in the next five years. Entrepreneurial mindsets were investigated through the perceptions of active and potential entrepreneurs towards business activities and business environment.

The main research objective was met by utilizing deductive approach and mixed data collection method. Primary data was gathered through semi-structured interviews of active entrepreneurs and an electronic survey of the population over the age 18.

The key empirical findings were general distrust of the population towards government, however increasing interest towards entrepreneurial activities. Moreover, large law-abiding attitude was found among survey respondents. At the same time, law-abiding intentions revealed were contradicting with the prevailing tax evasion habit of the majority of the interrogated individuals.

Based on the results of theoretical and empirical investigation, it was concluded that shadow economy mitigates present institutional inefficiencies, thus indirectly promoting the growth of entrepreneurship attractiveness. Thus, slow but stable entrepreneurship development in Russia is expected in next five years.

Key words: shadow economy, entrepreneurship, entrepreneurial mindset, Russia, economic freedom, institutional perspective, entrepreneurial process

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1 INTRODUCTION

Over the past twenty years, economic globalization process has started. It has reduced trade and investment barriers and created new integrated supply chains of outlying countries which previously were hardly available economically due to their location, political regimes, low level of economic development and numerous other reasons. Newly opened access to global capital, technologies, knowledge and talent has subsequently changed economic and business environments of potentially large economies (developing countries). Consequently, for past two decades paces of development and GDP growth rates of developing economies, as the first sign, have vastly outstripped those of more advanced economies. Moreover, breakthrough in the economic development promoted decrease of poverty, created new middle classes and broadened new markets for consumer goods and services in these economies. (Khanna & Palepu 2010.)

Opening and accession of large markets to the global market started shifting economic and political power towards emerging economies. Strong growth has centralized in a number of developing countries, increasing their shares in global income dramatically and making them major players on regional and global levels. (Kharas 2010.) Among emerging markets with the recent fastest economic growth are Brazil, China, India, Russia, and South Africa, known as the BRICS association.

The fast economic growth, which took place in these particular countries, was not random. For each nation, there are unique keys for economic development. However, economists and researchers have distinguished some common factors affecting economic growth. These factors include geographical location, natural resource base, human resources, demographical trends, capital accumulation potential, reallocation of labor and marketable surplus of agriculture. Other important determinants of economic growth are level of education and technical development, political freedom, level of inequality and size of the middle class. There are also determinants which are directly under the state control, such as trade

policy, fiscal policy, currency undervaluation, effectiveness of institutions and economy openness. (Bhalla 2012, 15-27.)

Factors, reflecting government intervention into the economy, in case of their weak performance, are considered the key determinants promoting the growth of underground economic activities, i.e. shadow economy. Researchers recognize different impacts of shadow economy as being both positive and negative in relation to the official economy. Moreover, most of the studies regard not only economic influences but also social consequences of the underground economy. Literature shows that the greater the size of shadow economy, the greater its impacts are. (Eilat&Zinnes 2002, 1235-1237.)

In transition countries, since they are going through a systemic transformation, shadow activity unavoidably grows (Eilat&Zinnes 2002,1246). Thus, transition economies are at risk to become a ground for prospering shadow economy on a constant basis. The risk especially increases if reforms are inconsistent and/or inefficient; the same as if acting in shadow stays more beneficial than official activities for a long period of time. In case of Russia, the transition process was unstable and accompanied by a deep economic recession (Rittenberg&Tregarthen 2012, 1434). The consequences that still have influence on economic growth today were an increase of crime, poverty, corruption, inefficient institutions and illegal economy.

As shadow economy affects not only the economy but also social sphere, it directly or indirectly influences all economic agents and participants. Moreover, it affects those participants, who are already active and those, who have not started their economic activity yet. Subsequent number of economic agents of each country are small and medium-sized businesses run by entrepreneurs. North (1997a) defined entrepreneurs as the main actors of change. Thus, to get a deeper understanding of the shadow economy's influences on the economic development, it is important to understand its impacts on the entrepreneurs, their mindset and initial will to start a new business.

Thus, first stage of the research is aimed to understand concepts of shadow economy and entrepreneurship and principals of interaction between them. Second stage aims to accumulate sufficient knowledge about shadow economy and entrepreneurship development in a case country based on the model constructed through theory investigation. It will observe current economic environment, peculiarities of entrepreneurship in Russia, perceived feasibility of doing business in Russia by potential entrepreneurs and its connection to the shadow economy. Thus, the research might be useful for new-entrants to learn present market situation and to avoid possible traps, the same as it could serve as a basis for further researches of shadow economy and entrepreneurship development in Russia.

1.1 Thesis Objectives, Research Questions and Limitations

This thesis aims to investigate the influence of shadow economy on the development of entrepreneurship in Russia. The main objective is to reveal the impacts of the underground economy on the activities of the entrepreneurs and peculiarities of their mindset, the same as peculiarities of potential entrepreneurs' mindsets. In turn, a deeper understanding of these processes will allow to reflect a common way of doing business in Russia today and attitudes towards business opportunities. Moreover, there is a possibility to evaluate the influence of shadow economy on entrepreneurship development through attitudes in a context of Russian institutional framework. That is the final goal of the research.

One of the most important tasks, while making a research, is to determine clearly a research question. It should answer the research problem and illustrate what the research is. (Myers 2013, 20-21.) The research question of this thesis is:

How does the presence of shadow economy affect entrepreneurial mindset and entrepreneurial development in Russia nowadays?

It is hard to answer the research question without asking further sub-questions. Sub-questions will help cover the whole area of knowledge, which is necessary to answer the research question. Sub-questions asked, for this study, are:

- What is shadow economy?
- How is shadow economy related to entrepreneurship?
- How does shadow economy influence willingness to start a new business and mindset of active and potential entrepreneurs in Russia?
- What are the prospects for the development of entrepreneurship in Russia for the next few years?

There are some limitations and issues to be mentioned for this research. Firstly, this research concerns only Russian nationality and its results may not suit cases of other countries. The main reasons for that are the unique history, national mentality and even geography.

Secondly, SMEs, in this study, are regarded as the result of an entrepreneurial activity but not as an independent entity. Thus, observation of SME's activities in a shadow economy's context is based on rationality of decision-making processes and peculiarities of entrepreneurial thinking.

The third limitation of the study is that research does not focus on the psychological reasoning of changes in entrepreneurial mindsets, whereas observes only its results. However, influence of national mentality, historical and social processes are taken into account.

One more limitation concerns the empirical part of the thesis. The questionnaire aims at different age groups of people, status and work experience, the same as entrepreneurship experience. In the survey analysis are used answers of people above 18 and under 64 in accordance with TEA indicator provided by Global Entrepreneurship Monitor. However, the main focus, while analyzing the results of the survey, will be on the answers of the age group from 18 and to 45 years. The reason for that is

that age group will be the most economically active age group during the next two decades. Consequently, people out of that age group are more likely to become entrepreneurs in the next several years. It also needs to be noted that the answers of people under 18 years will not be analyzed in this research.

The last issue to be mentioned concerns the knowledgebase of shadow economy concept. Some theoretical materials used in this thesis, especially those which explain shadow economy concept, were written and published more than ten years ago. However, they are considered to be the corner stone knowledge of the topic, as they are not conflicting with modern material and are used as a basis.

1.2 Theoretical Framework

The aim of the thesis is to find out the influence of shadow economy on the entrepreneurial activities and mindsets in Russia. Moreover, it aims to find out the overall effect it has on the macroeconomic development of the country. That is why the theoretical part of the study consists of three sections.

The first theoretical section provides all necessary information about the “shadow economy” concept. The section covers the definition and the types of activities referred to as the shadow economy. The theory also explains the nature of shadow economy, its relations with corruption and possible impacts in the context of market economy. Thus, the aim of this section is to characterize shadow economy, making the reader familiar with the core and the nature of the concept.

As the study concentrates on the entrepreneurial mindset and activities, it is important to observe the concepts “entrepreneurship” and “entrepreneur”. Thus, the second theoretical part covers the definition and factors promoting or hindering entrepreneurship. Moreover, the important part of this thesis is the entrepreneurial mindset, so the theory of decision-

making process, as an entry decision, is also explained and moduled into the entrepreneurial process.

1.3 Research Methodology and Data Collection

When the research topic and research questions are formulated, the next step is to find or create a suitable theoretical framework before, during or after empirical part of the research. The theoretical framework should match the research problem chosen for investigation. Availability of theory and nature of the research play a great role in the creation of the theoretical framework. Thus, the type of theoretical framework chosen, the theory-building or theory-testing, largely determines further research design, starting from the research approach. (Myers 2013, 22-23.) It is also useful to relate research approach with the adopted research philosophy (Saunders, Lewis & Thornhill 2009, 124).

There are a number of reasons why the choice of research approach is important. Firstly, it helps with the research design. Secondly, the research approach influences the choice of research strategy applicable to answer the specific research question. Thirdly, the correctly chosen research approach adapts the research design to meet the constraints of the research.

There are two main research approaches: deductive and inductive. Deductive research is referred more to a scientific research. It involves the development of a studied theory into a hypotheses for the further rigorous testing. It is mainly applied in order to explain causal relationships between variables. There are other important characteristics such as utilization of quantitative data for the hypothesis testing and generalization of the results. The inductive approach alternatively is more suitable for social sciences and deals with qualitative data. The inductive approach involves the collection and analysis of data at first and then builds theory based on the results. This research approach is usually utilized in order to understand the meanings that individuals attach to specific events. This in turn makes the inductive approach more suitable for researches aimed to

understand better the context of particular events. Moreover, the inductive approach is more flexible to changes in a research emphasis than the deductive approach. It also possible and often advantageous to combine two research approaches in one study. (Saunders et al. 2009, 124-127.)

The research philosophy of this thesis is pragmatism. Furthermore, much theory is available on the research topic. However, to meet research objectives and to provide a full answer to the research question, both deductive and inductive research approaches are used in the thesis.

After the research approach is chosen, the researcher has to define the research method, which is usually referred to as a variety of data collection methods. (Kuada 2012, 93.) There are two basic research methods: qualitative and quantitative. Quantitative research is any data collection technique or data analysis process that produces or deals with the numerical data. Alternatively, qualitative method generates and utilizes non-numerical data. Usage of a single method either qualitative or quantitative in data collection and analysis is named mono-method. However, multiple methods can be utilized both in one study. Multiple methods include four different possibilities. Multi-method quantitative study combines several quantitative data collection techniques with associated analysis procedures. Similarly, multi-method qualitative study utilizes more than one qualitative data collection and analysis techniques. Mixed-methods uses both qualitative and quantitative data collection techniques and analysis procedures in either parallel or alternately but does not mix them between each other. Mixed-model utilizes both quantitative and qualitative research methods and mixes them, i.e. qualitative data is analyzed quantitatively and vice versa. (Saunders et al. 2009, 151-152.)

As this thesis investigates how shadow economy affects the entrepreneurial mindset and activity, it is reasonable to collect both qualitative and quantitative data and analyze them respectively. Thus, mixed method is used.

This research utilizes both primary and secondary data. Qualitative primary data is collected through a semi-structured interview and investigates how active entrepreneurs see doing business in the environment of shadow economy. Quantitative primary data is collected through a web survey and regards the attitudes of potential entrepreneurs towards doing business in Russia.

Secondary data is another useful source of information for the thesis, which is utilized for theory and case study development. It is collected from such secondary sources as scientific articles, research papers, books and Internet based resources.

1.4 Research Structure

This thesis mainly consists of theoretical and empirical parts. The theoretical part introduces the concepts of shadow economy and entrepreneurship and regards them in the context of the Russian economy. The empirical part investigates the relations between shadow economy and entrepreneurial mindsets based on the results derived from studying theory. The final phase of the thesis is a description of entrepreneurship in Russia and prospects for economic development through it. The last chapter summarizes the research outcome and provides suggestions for further researches. FIGURE 1 below presents the thesis structure.

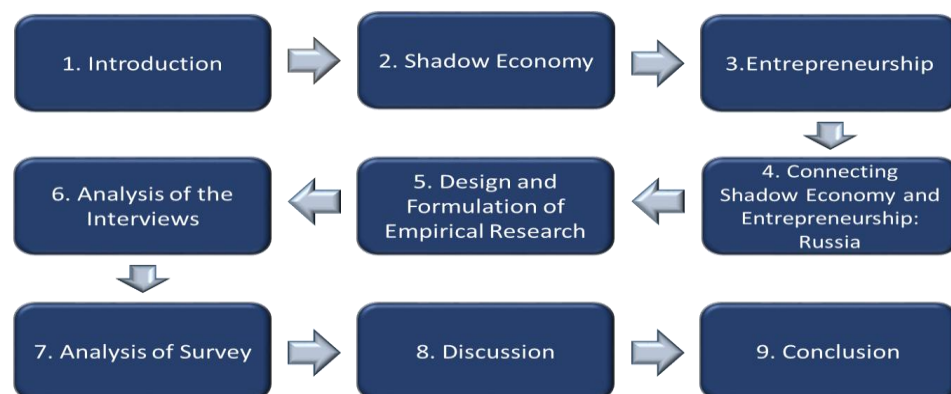


FIGURE 1. Thesis Structure

The introduction outlines the general framework of the study and its purpose. It provides research questions and objectives, theoretical background and research methodology utilized to answer the stated research questions. The second chapter describes characteristics, causes and impacts of shadow economy concentrating on the transition economies. The third chapter provides the definition and nature of entrepreneurship and describes the factors that promote and hinder entrepreneurial activity. The fourth and the last chapter in the theoretical part presents the key theoretical findings and discusses their relation to each other in general and in case of Russia; thus providing the basis for the following empirical part.

Chapter 5 introduces the reader to the empirical research design and data collection process. Chapter 6 provides analysis of the semi-structured interviews, whereas Chapter 7 observes and analyses data gathered from the electronic questionnaire, applying descriptive statistics and multinomial regression model. Chapter 8, based on theory investigation and results of the empirical investigation, provides comments upon pace of entrepreneurial development in Russia. Lastly, Chapter 9 contains conclusions of the entire research, discusses reliability and validity of findings and makes suggestions for the further researches.

2 SHADOW ECONOMY

This chapter observes the phenomenon of shadow economy. It goes through the definition and its peculiarities and cover types of activities referred to shadow economy. It is important to investigate causes of shadow economy and its effects on the economic performance and growth, therefore they are either observed in this chapter. Due to complexity of the phenomenon, this chapter deeply analyzes existing literature and regards unofficial economy from different viewpoints, concentrating on its peculiarities in the transition countries.

2.1 Defining Shadow Economy

Today existence of the shadow economy in each country is an undisputable fact. Economists drew particular attention to this phenomenon in the twentieth century. However, still researchers cannot give shadow economy an exact definition due to complexity and versatility of the subject (Eilat&Zinnes 2002, 1234). Literature usually regards only characteristics of shadow activities. Broadly identified characteristics are tax evasion, avoidance of set regulations and currency requirements, officially unrecorded activities and per se illegal economies. These characteristics form a typology of shadow economic activities. Such typology creates numerous situations from the point of each strict definition can be given. (Eilat&Zinnes 2002, 1234.)

It is important to consider the fact that there are two different perspectives on the shadow economy subject: economic and legal. Thus, from the economic perspective informal economy is defined as a sector, which does not directly contribute to the national tax revenue and gross national product. Whereas, from legal perspective informal economy is the economic activities, which are forbidden and penalized by the law. (Edelbacher et al. 2015, 1.) In broad sense, the economic activities may be distinguished into white economy, which represents legal and formal economic activities, and black economy, which is illegal and informal. However, there is one more distinction named as a gray economy. Gray

economic activities fall in-between white and black economies. Such type of activities is legal but informal, i.e. unrecorded and hidden from the state. (Edelbacher et al. 2015, 1.)

As economic activities are categorized by being formal or informal and legal or illegal, it is important to understand the base for the existing division. Formality of the economic activity is defined by fiscal and other regulatory economic factors. Whereas, legality is defined by social and political factors based on the accepted social norms and criminal law. All the factors have developed in specific time and place in dependency with the history and culture; therefore, they vary from country to country. (Edelbacher et al. 2015, 2.) The principal and shared characteristic of the factors determining formality and legality of the economic activity is their official state consolidation. Government as the main regulatory body forms these distinguishing factors (Paoli 2003, according to Edelbacher et al. 2015, 2). Thus, any economic activity, which does not follow states regulations, is defined as informal activity. Paoli (2003) proposed shadow economy to be an entity that exists only due to existence of formal economy. In case of an ideal market economy without any state intervention and regulations there would be no division into formal/informal and legal/illegal activities. Therefore, shadow economy can be described as the result of relations between government and economic activity. (Paoli 2003, according to Edelbacher et al. 2015, 2.) Similar ideas Tanzi (1982) provides describing shadow economy as a tendency of economic participants to perform their activities avoiding any state intervention (Eilat&Zinnes 2002, 1235).

In order to meet the research objectives of this study, shadow economy is defined as unregistered execution of economic activities in order to avoid any state regulations and intervention into business processes.

2.2 Typology of Informal Economic Activities

The previous subchapter states that economy and economic activities are divided into formal and informal, or in other words, regulated and

unregulated economies. Informal economy has numerous names and in different studies, the phenomenon is called differently. Thus, the informal economy can be called as the shadow economy, the unofficial economy, the parallel economy, the hidden economy, the underground economy etc. (Dobovšek&Slak 2015, 9.)

The same as the informal economy has the variety of names, it is also defined differently in literature. (Dobovšek&Slak 2015, 9.) There are some broad definitions describing shadow economy. Sassen (1997, 2) determines shadow economy as the income-generating activities existing outside of the formal set of regulations and thus opposing formal economy, where similar activities are regulated. Webb provides another broad definition. He describes informal economy as economic activities, which stay outside formal institutional regulations and therefore illegal, but at the same time which fall within informal institutional frames, i.e. are accepted by social norms (Webb et al. 2012, 3). Frey and Schneider (2000, 2) state the most commonly used definition to be the one, which relates shadow economy to the official national income. In this case informal economy is defined as all value-adding activities, which are presently unrecorded in the gross national product (GNP), even if they should be (Schneider & Frey 2000, 2). However, described definitions are not the only existing and there are much narrower ones. Thus, Ponsaers, Shapland and Williams (2008, 645) recognize three contrasting types of the definitions within "narrow" group. He distinguishes enterprise-, job- and activity-based definitions. Enterprise-based definitions determine discrepancy within work organization processes and links between the actors in informal enterprises compared to the formal ones. Job-based definitions indicate differences between potential of informal and formal sector to provide income for the lower-level social groups. Whiles, activity-based definitions examine criminality of the activity itself. (Ponsaers et al. 2008, 645.) Thus, the conclusion can be made, that definition of informal economy varies according to the research focus. Schneider and Frey (2000, 2) concluded similarly by pointing that there was no single definition, as it was depended on the research purpose.

Such great variety of definitions shows the informal economy as a multifaceted concept. Moreover, different meanings of shadow economy reflect different perspectives of the economists, jurists, criminologists and politicians upon the subject. Two sets of definitions could be mainly differentiated. The first set of definitions describes legal income-generating activities, which are partly or entirely unregistered. The second set includes both legal activities and those referred to criminal economy. (Dobovšek&Slak 2015, 10.) While as the first set of definitions is made from the economic perspective, the second set is made from a more criminological or legal perspective. As it was described in the previous subchapter, there is a division of economic activities based on their formality and legality. Thus, except official economy there are several subtypes of the informal economy, which are illustrated by FIGURE 2 below (Dobovšek&Slak 2015, 11).

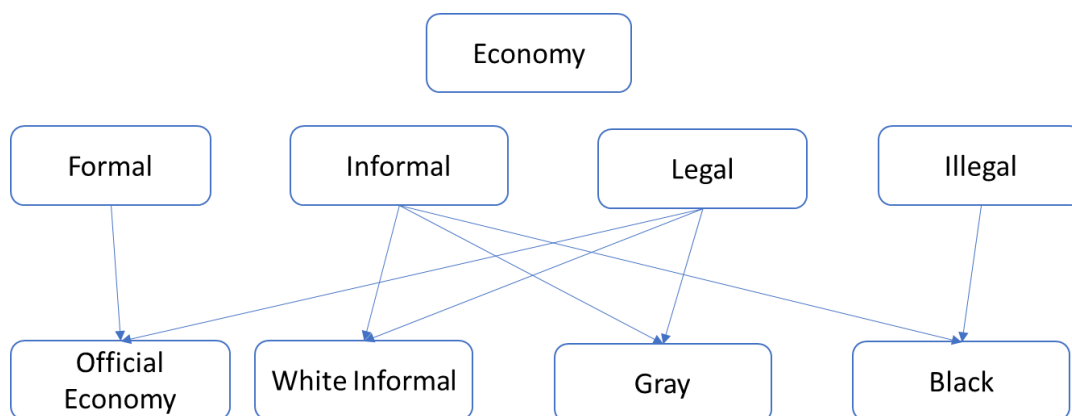


FIGURE 2. Types of shadow economy

The first subtype of shadow economy is the white informal economy. It can be described as legal but unregulated economic activities. Such type of shadow economy is characterized by the activities generating profit in a legitimate way. However, obtained revenue is protected from taxes or

enriched by different forms of interest hidden by financial or accounting measures. Henry and Sills (2006) describe white informal activities as bypass of the rules and processes of exchange utilizing as means of exchange favors, privileges, perks and barter instead of money. Such activities are not illegal, but not formal either. (Henry & Sills 2006, according to Dobovšek&Slak 2015, 12.) Thus, legal organizations and activities form white informal subsector, which is associated mainly with such shadow activities, as tax evasion and bartering.

The second subsector of informal economy is gray economy. Gray economy is described as nonregulated and unreported economic activities. Thus, this subcategory includes legitimate economic activities that are performed and are paid while staying unrecorded. Gray economy is the broadest and the least regulated informal subcategory.(Dobovšek&Slak 2015, 13.) The unrecorded activities within this sector range from small income-generating activities such as tutoring to the unrecorded production of goods and services (Losby et al. 2002, according to Dobovšek&Slak 2015, 13). Cash-in-hand methods of payment are mainly utilized within the sector, including payment of wages to the formal employees (Dobovšek&Slak 2015, 13). Williams and Nadin (2012) identify that rather great number of entrepreneurs are participating gray economy, especially at the beginning of their business activities (Dobovšek&Slak 2015, 13). Some authors also mention that gray subsector is mainly tolerated by the state until those that are hard to formally employ perform the informal activities (Dobovšek&Slak 2015, 13). Gray economy participants usually perform informal activities, which include tax evasion, avoidance of state regulations and failure to appear in official statistics.

The last subcategory is black informal economy, which involves per se illegal activities. Such activities commonly determined by supply of goods and services prohibited by criminal law. Moreover, some studies provide division of the illegal trade into three forms. The first form is the trade in illegal goods and services, such as drugs and prostitution. The second one is the trade in legal goods, which were produced illegally, violating

regulations and avoiding statistics in order to evade taxes and duty payments. The last form is a trade accompanied by illegally gained competitive advantage or profit through unrealized sales, tax evasion schemes and other transactions. (Dobovšek&Slak 2015, 13.) Black or criminal economy utilizes all kinds of shadow activities: tax evasion, avoidance of regulatory requirements and registration, and activities against criminal law.

2.3 Causes of Shadow Economy

While investigating the phenomenon of shadow economy, it is important to understand the driving forces for its existence and growth. Dobovšek and Slak (2015, 11) state that the main reason for the presence of shadow economy is the existence of the demand for its informal goods and services. They also suppose the benefits of informal economy to be the causes for its existence and growth. The same opinion is shared by Eilat and Zinnes (2002, 1235). They analyzed the causes of shadow economy through its costs and benefits, as incentives for economic agents to operate formally or informally (Eilat&Zinnes 2002, 1235).

Most of the researches identify mainly four shadow activities, excluding those that are per se illegal. These activities include avoidance of tax payments and payments of social security contributions, avoidance of market regulatory requirements and compliance with administrative procedures. (Eilat&Zinnes 2000, 1234; Schneider 2007, 5.) Listed informal activities provide certain benefits to economic agents. Due to this reason, the activities point out at factors, which have caused the demand for gaining these benefits informally, namely, at causes of informal economy.

2.3.1 Taxation

One of the most commonly mentioned causes of shadow economy in literature is tax burden and tax rates. It is proposed that high marginal and total taxes negatively affect the decision of economic agents to operate officially, thus pushing them to the informal sector (Eilat&Zinnes 2002,

1235). Schneider (2000, 82) also states that taxes influence the consumption choice between formal or informal goods and services. Moreover, tax rates have impact on the choice of employment in official either unofficial sector. Thus, tax rates and social security contributions can stimulate labor supply to the informal economy. The difference between total cost of labor and after-tax earnings from work in official sector creates an incentive for economic agents to remove or reduce it. The greater is the difference than the greater is the attractiveness of informal sector. As this difference is dependent mainly on the overall tax burden and social security system, they are considered the key determinants of the shadow economy presence and development. (Schneider & Enste 2000, 82; Schneider & Williams 2013, 37-38.)

Earlier described determinants are not true only for the private sector but also for the household. Thus, the main incentive for both tax evasion and work in shadow is the amount of income that should be announced to the tax authorities. Neck, Hofreither and Schneider (1989) find that higher level of marginal income tax rates implies greater supply of informal labor. At the same time, the researchers also show that demand for the informal labor and supply of the informal goods are directly dependent on the indirect taxes and wage rates in formal economy. Thus, disregarding other factors affecting unofficial economy it is possible to suppose that higher indirect and marginal income tax rates increase both the amount of labor and the amount of goods bought and sold in the informal sector. Furthermore, changes of wage rates in the official economy may also influence positively or negatively the amount of the informal labor. (Neck, Hofreither and Schneider 1989 according to Schneider & Enste 2000, 83.)

In another study, Neck and Schneider (1993) investigate the dependency between the size of shadow economy and the complexity of the tax system. They state that more complex income tax systems, which provides various tax reductions and exemptions, gives opportunity for a more legal tax avoidance than a simple tax system. As individuals now can avoid taxes legally excluding the risk to be caught and punished, tax evasion through the underground activities become less profitable.

Moreover, reduced tax burden encourages households to work in the formal sector with access to public services, thus decreasing attractiveness of informal sector. Consequently, simplification of the tax system through broadening the tax base and abolishment of exemptions can increase the size of the informal economy. Observation of Austrian tax reform in 1989, which reduced marginal income tax rates but simplified tax system, revealed no decline in Austrian shadow economy, despite the direct taxes had been decreased. The conclusion was drawn that direct, indirect taxes had subsequent influence on shadow economy, but the complexity of tax system and regulation burden were important as well. In case of Austrian tax reform no decrease in shadow economy happened because lower tax burden was outweighed by simplification of tax system with broader tax base and increased regulation. (Neck & Schneider 1993 according to Schneider & Enste 2000, 84.)

Cebula (1997) provided another evidence of income taxes influence on the shadow economy (Schneider & Enste 2000, 85). He revealed that the relative size of shadow economy in the United States is affected through income tax rates, penalty policies and IRS audit probability. His conclusion emphasizes the role of government actions. The results of the investigation state that maintenance of the existing marginal income tax rates and prevention of their growth may avert the growth of shadow economy. Moreover, it was supposed that increase in penalties and number of IRS audits might reduce the size of the informal sector. (Cebula 1997 according to Schneider & Enste 2000, 85.) Despite theoretical assumptions of the correlation between deterrence and the size of shadow economy, there is shortage of substantial evidence on the practical effects of deterrence. The lack of empirical studies is due to the difficulty in obtaining consistent data on the frequency of audits and necessary legal background, especially at the state and international levels. (Schneider & Williams 2013, 34-35.) Schneider and Williams suggest by analyzing existing empirical studies that punishments and fines may be important; however, risk of detection itself has greater effect on the tax evasion. They provide two possible explanations for the flimsy evidence of

deterrence effects. The first one is the relationship between tax morale and deterrence. The assumption is that stricter punishments and more obsessive detection measures may decrease the tax morale. The second explanation is that taxpayers usually fail to understand correctly the level of punishment and risk of getting caught. (Schneider & Williams 2013, 37.)

Johnson, Kaufmann and Zoido-Lobatón (1998b, 4-5) found in their cross-country analysis that share of shadow economy in total GDP is higher for the countries with greater regulations. They also found that higher tax burden promotes more underground activity. Their third finding was that in the countries with the greater extent of corruption informal sector is larger. Based on the research results the suggestion was that regulatory discretion is eventually more important determinant than tax rates and social security contributions. The researchers explain their conclusion by feeble regulations and weak rule of law, which lack effective supervision to prevent bureaucratic arbitrariness and corruption. (Johnson, Kaufmann & Zoido-Lobatón 1998b, 5.)

2.3.2 Intensity of Regulation

Increase in regulations limits the variety of choice opportunities for the individuals within official economy. Number of laws and requirements, as licenses, labor regulations and trade barriers measure the intensity of regulation. (Schneider & Enste 2000, 85.)

Literature states that regulation tends to increase labor costs in the formal sector. Because most of the labor costs can be shifted onto employees, the wages in the official economy decrease. Thus, regulation promotes movement of labor from the official economy to the informal sector, where these costs can be avoided. (Schneider & Williams 2013, 38.) There are two main aspects in driving forces for the informal economy by overregulation and labor costs. The first aspect is unemployment rate. Most of the OECD countries are suffering from widespread unemployment due to high labor costs. This can be regarded as one of the causes for the increase in unofficial activity. The second aspect is the regulation of

working hours in official economy. Governments to struggle with high unemployment implemented the reduction in working hours. The idea behind the policy was to increase employment through the redistribution of work, the quantity of which is in fact limited. However, governments omission was that forced reduction in working hours against wishes of an employee would lead to potential increase of his working hours in the informal sector. (Schneider & Enste 2000, 82.) Early retirement and part-time working also provide incentives for individuals to work in untaxed and unregulated shadow economy (de Dijsel 1984; Riebel 1984 according to Schneider & Enste 2000, 87). Thus, the conclusion derived is that successful redistribution of work is only possible, if it is done in accordance with individual's preferences (Schneider & Enste 2000, 87). The reasonable suggestion for economic policy development is to implement more flexible working hours corresponding to the employees preferences in order to reduce probability of the decision to work in the underground (Schneider & Enste 2000, 87).

Johnson, Kaufmann and Zoido-Lobaton (1998b, 3) found that in countries with less regulation the share of shadow economy is lower. Similar results were obtained by Friedman et. al (2000, 476), who find that overregulation is positively correlated with the size of informal sector. These findings, thus, show where the governments should put more emphasis. In order to reduce or at least to prevent the growth of the unofficial sector the density of regulations should be reduced, while as the improvements to the enforcement of laws and regulations should be made. However, there are two reasons why government would controversially increase the intensity. The first reason to increase number of laws is that bureaucrats thus can increase their power and employment in the public sector. The second reason is the obtainment of votes from individuals, who gain from shadow activities. (Schneider & Enste 2000, 86.)

2.3.3 Public Services and Institutions

Higher quality of public services and institutions can decrease activity of the informal sector. Moreover, combination of public services with impacts from changes in tax rates can provide dynamic effects, either positive or negative. Thus, increase of the informal sector causes reductions in state revenues. Lack of government finances further leads to the deterioration of public goods and services. In order to obtain more revenue government increases tax rates that, in its turn, pushes more economic agents to the shadow economy. Therefore, such processes may result in a vicious circle. However, if correct policies are implemented, the processes can turn into a reverse, virtuous circle. (Schneider & Williams 2013, 39.)

Johnson et al. (1998a, 4) find that share of unofficial sector is smaller in countries with less regulations, lower tax burden, less corruption and better rule of law. They further represent two economic equilibria. In the first equilibrium, tax revenues and regulations are low, ensuring high state revenues; consequently quality of public goods is high, whereas informal sector is small. In the second equilibrium, resources are concentrated in the informal sector, thus, government revenues are low, quality of public goods is poor, the same as productivity of the official sector. Hence, second equilibrium is characterized by presence of large and growing shadow economy. (Johnson, Kaufmann & Zoido-Lobaton 1998a, A45.)

Regarding quality of public goods there is a peculiarity with a social welfare system, particularly with the social transfers. Application of neoclassical leisure-income model in the researches allowed deriving the evidence of the social welfare system's effects on the size of shadow economy. It is stated that social welfare system provides negative incentives for its beneficiaries to search for a job in the official sector. The individuals obtain higher income by receiving welfare payments, while as working in the shadow economy, than if they would be working in the official sector. (Schneider & Enste 2000, 86.)

Schneider and Williams (2013, 40) also emphasize the role of institutional quality in relation to the shadow economy size. Tax burden and regulations themselves may be even less important than efficiency of their application by a government. Such assumption is made due to the crucial role of institutional efficiency in the decision to start operations in the informal economy. Thus, strong rule of law and unbiased juridical system that protect property rights and contractual enforceability increase benefits and attractiveness of the official economy. Controversially, corruption of the officials eliminates benefits of the formal sector, such as availability of high quality public, social and private services. Hence, corruption is associated with the larger unofficial sector. (Schneider & Williams 2013, 40-41.)

While regarding impacts of public sector and institutions on the shadow economy, it is important to note that different political and constitutional systems may be at different extent favorable for the growth of unofficial economy. Thus, failure in building market economy with the efficient institutional framework may provoke in part the development of shadow economy; that is especially true for transition countries. (Schneider & Enste 2000, 88.)

The policy is considered to be efficient if it is characterized by a transparent tax system with a revenue mainly spent on the public services. Economic agents operating in the formal sector benefit from higher quality of public services but are influenced negatively by taxation. Therefore, ideal policy is the one with low taxes, which are spent in an efficient way. Federal system and direct democracy considered less favorable for unofficial economy. This is due to their self-regulatory nature based on the internal political competition and preferences of majority of voters. However, in case of vicious circle, existing rules and institutions may become unacceptable for the society. This can result in abandoned or undeveloped loyalty to the democratic political institutions, since democratic voting is less attractive than unregulated shadow economy. Such situation can be found in some former states of Soviet Union. (Schneider & Enste 2000, 88.)

2.4 Effects of Shadow Economy

Today effects of unofficial sector on the overall economic development remain vague (Schneider & Enste 2000, 89). In order to study impacts of shadow economy on the economic growth, firstly it is needed to understand how informal sector affects the official economy.

Number of studies integrated shadow economy into macroeconomic model to examine its effects on the resource allocation. Researchers thus obtained entirely different results. This led to appearance of opposing views on the influence of underground economy upon the overall economic growth.

It is known that shadow economy subsequently reduces tax revenues, quality, and quantity of supplied public goods. This idea led to the development of a hypothesis that reduction of underground economy would bring the substantial increase in tax revenues, hence quantity and quality of public services would increase that could promote economic growth. (Schneider & Enste 2000, 89.) Loayza (1996) provides some evidence for the hypothesis. He obtains the result of negative correlation between indices of public infrastructure and shadow economy, assuming the public infrastructure to be the key factor for economic growth. His derived conclusion is that in economies with tax burden larger than optimal and with weak enforcement of compliance, increase in size of unofficial sector starts to hinder economic growth. However, this study gained some criticism. (Schneider & Enste 2000, 89.) Thus, Schneider and Enste (2000, 89) and Asea (1996, 165) criticize the key factor of the model, as public goods were represented as a subject to congestion. Such representation of public goods goes against its general definition of goods available for everyone and non-limited in its quantities. Asea (1996, 165-166) provides more criticism of the implemented model.

Negative effect of shadow economy on the economic growth presented by Loayza is not widely accepted (Schneider & Enste 2000, 89). There are two prevailing views on the underground sector. The first traditional view

explains informal economy as a reverse part of the economy, which emerges in response to market imperfections intrinsic to the transition countries. The second neoclassical view regards shadow economy as the optimum response to the existing economic environment. (Asea 1996, 164.) Schneider (1998b) found the positive effects on indirect tax revenues and economic growth because over the half of earnings gained in informal sector are spent in the official economy immediately (Schneider & Enste 2000, 89-90). Asea (1996, 166) views the positive influence of the shadow economy on creation of new markets, reinforcement of entrepreneurship, increase of financial resources and improvements of institutions.

Eilat and Zinnes (2002, 1236) believe that for economic growth economic activities are better to be performed in official economy, *ceteris paribus*, rather than unofficially. However, they note that due to lack of alternatives to the shadow economy, activities are better to be done in shadow than not to be done at all. The only exception is criminal black economy, which is harmful by the nature. The reason for the former conclusion is the acknowledgement of both positive and negative impacts of shadow economy on the official one.

Negative impacts can lead to macroeconomic, microeconomic and social problems. One of the negative impacts is earlier described vicious circle, resulting from shadow activities, which cause distortions in tax revenues and deterioration of public goods. Constant lack of financing can lead to the budget deficit. Furthermore, lack of budgetary financing may force government to cover the difference via inflationary financing, which can cause further economic destabilization.

Another negative impact is less effective macroeconomic policy influencing macroeconomic stability. Thus, official statistics fail to provide sufficient information for macro-policy decisions (Tanzi 1999 according to Eilat&Zinnes 2002, 1237). Moreover, shadow economies weaken the monetary policy. This happens due to difficulties in obtaining financing through the banking system for the unofficial activities. The banking

system and cash are used less, while as barter and foreign currencies become more attractive for transactions. (Eilat&Zinnes 2000, 1237.)

Shadow activities also cause microeconomic efficiency problems. One of them is distortions in resource allocation. Tax evasion provides unfair competitive advantage in prices for the shadow economy firms over the official ones. Moreover, unofficial organizations are at some point more attractive for the labor due to general avoidance of regulations. Another issue is that shadow economy participants usually have problems in obtaining financial collateral, affecting their investment decisions. Thus, resources may be distributed to the sectors, which are the most yielding, hence, the most attractive for the shadow economy. Among these sectors are trade, construction and services. Regarding the size of unofficial sector, shadow activities may affect the composition of overall economic output. (Eilat&Zinnes 2002, 1237.)

Shadow economy is excommunicated entirely or partially from public services. Consequently, risk of doing business is greater in the informal sector. Moreover, shadow participants have difficulties in obtaining funds from capital markets. This all makes large shadow economy almost survival economy, where activities and focus are on the short-term turnover, ignoring long-term view. The consequences may be decapitalization of assets in shadow firms and more labor-intensive operations accompanied by the efficiency losses. Furthermore, operations in unofficial sector involve additional direct and time expenses raising production costs. (Kaufmann & Kaliberda 1996, 27; Eilat&Zinnes 2002, 1237.)

Large unofficial economy is also negatively influences social sphere. One of impacts was found by Schneider and Enste (2000, 88) and described earlier. The researchers supposed that great extent of underground activities, resulted in a vicious circle, might lead to a general distrust towards government and existing political system. The consequence may be a disintegration of social norms, especially those maintained by the law. Another probable problem of expanding informal sector is acceptability of

social services provided by social safety net for workers employed in unofficial sector. One more concern is association of underground activities with anti-competitive conduct, which may provoke switch from existing consumer surplus to producer surplus, thus increasing inequality. (Eilat&Zinnes 2002, 1237.)

If to observe shadow economy from neoclassical view, assuming the fact that its presence is a result of existing imperfections of the official economy, number of positive effects can be found. One of them widely recognized in literature is that shadow economy may act like a safety net, which helps to maintain economic activity, when it faces threats that increase costs of the official production. For example, implementation of regulations increasing unemployment or hindering economic activity in a particular sector. Another positive effect, mentioned earlier is expenditure of unofficially earned money in the official economy (Schneider 1998b according to Schneider &Enste 2000, 89). Shadow economy also increases competition to the formal sector. Moreover, it has positive effect on income distribution via employment of individuals of lower income. Other recognized benefits are contribution to the creation of markets, increase of the financial resources, indication of upper bounds for government regulations and opportunism of bureaucracy and, finally, provision of entrepreneurial experience. (Asea 1996, 166; Eilat&Zinnes 2002, 1237; Schneider &Enste 2000, 89.) Overall investigation of shadow economy's impacts on the economic growth by various studies both theoretically and empirically found the results to be ambiguous (Schneider &Enste 2000, 89).

2.4.1 Competition

One of the major benefits of market economy is increased efficiency in resource allocation, which is gained mainly through competition. Thus, regarding effects of shadow economy on economic growth, it is important to consider its effects on the nature of competition. Eilat and Zinnes (2002,

1244) suggested analyzing impacts of shadow economy on competition through relationship of the latter with market structure and market conduct.

Market structure involves issues of organization size, ownership and sectoral output composition. Literature suggests that informal economy affects organizations depending on their size. For small companies it is easier to hide their activities than for the large companies, due to smaller scale of shadow activities. However, operations in shadow may hinder the growth of firm due to general short-term orientation and trouble to raise funds on capital markets. Large firms participate in a significant part of the unofficial economic activities. These companies produce much more than they declare in order to avoid taxes or due to internal corruption (employee stealing). Large shadow economies also leave a little room for medium-sized business, while as small firms face difficulties to graduate. Thus, economy with substantial shadow activity usually lacks medium-sized firms. (Eilat&Zinnes 2002, 1244-1245.)

Changes of sectoral composition output because of unofficial activities may happen due to several reasons. Firstly, due to excommunication from capital markets, sectors requiring financial inputs become less attractive for the shadow activity and may suffer from increased tax burden, while operating officially. Secondly, shadow economy seems more attractive for new entries than official economy, due to reduced costs of entry and increased relative profitability. Thirdly, as existence of unofficial economy is connected with a greater activity of small firms, sectors related to the economies of scale produce less output than they would do otherwise. Thus, shadow economy is mainly associated with the trade, agriculture, tourism, construction and services. (Eilat&Zinnes 2002, 1246.)

There are several peculiarities of ownership developed under shadow economy influence. Distancing from capital markets and common sources of financing, makes shadow firms to rely mainly on own-financing, like retained earnings or investment of owner's personal funds. Another peculiarity is based on public-private divide. Private organizations are much more profit-oriented than public ones, thus they are expected to be

more associated with the unofficial activity, especially large businesses. However, private firms have stronger governance than public ones. Therefore, in public companies management opportunism is more developed. Management opportunism based on personal gain usually summarily outweigh tax evasion activities. Thus, large-firm shadow activity is associated more with public than private organizations. The last issue of ownership is associated with the foreign investments. Foreign investors avoid participation on the markets with large shadow economy. Presence of large unofficial activity decreases potential competitiveness of foreign economic agents on the market and signals about existing corruption and bureaucratic overregulation. (Eilat&Zinnes 2002, 1245.)

Shadow economy also has influence on market conduct. Firstly, due to lesser presence of foreign firms, competition threat is decreasing. That leads to higher prices on the market. Moreover, large shadow economy complicates implementation of regulations and antitrust policies that are needed to support competition and to restrain monopolistic intentions. In addition, firms try to adopt and maintain vertically integrated organizational structure, which helps to hide activities. (Eilat&Zinnes 2002, 1245.)

Changes in market structure and conduct influence allocative efficiency and rate of innovation, which are two main measures of competition effects on the economic performance. As it was noted earlier, participation in shadow activities changes the size distribution of the companies. Thus, small firms remain small; while as large ones gain more power on the market. Another effect of change in distribution of firm's size is hindered activity in sectors relying on the economies of scale. One more deflection from allocative efficiency results from the shift in sectoral composition output to the sectors, which are more attractive for the unofficial activities. Moreover, decrease of foreign participation and difficulties in execution of anti-monopolistic regulations decrease competition even more. These facts may result in the shift of market power from consumers to the private sector. As consumer surplus is the main reason for the efficient resource allocation, economic growth may slow down in the sectors with large unofficial activity. Another important issue of allocative efficiency loss is

reduction of exchange and trustful collaborating between shadow firms. This happens due to weak protection of property rights and weak contract enforcement. The result is lack of intermediaries on the market, hence, reduced specialization. Lack of competitive pressure results in the firm efficiency loss and necessity of high efficiency itself, thus hindering development of innovations. Decreased allocative efficiency, lack of specialization and technological lag decrease international competitiveness and may increase the risk of economic breakdown. (Eilat&Zinnes 2002, 1244-1246.)

2.4.2 Entrepreneurship

Estrin and Mickiewicz (2010, 27-28) set up the first cross-country study investigating influence of shadow economy's size on likelihood of entrepreneurial entry both in general and in potentially high-growth activities. They find that probability of entrepreneurial entry decreases depending on the size of the informal economy. Thus, larger is shadow economy, lesser is likelihood of entrepreneurial entry. Another their finding reinforces the previous one: large shadow economy gives a perception of a higher competition for entrepreneurs at the moment of entry decision. This perception may retain entrepreneurs from an establishment of new businesses. Such competition perception effect is stronger in cases of high growth aspiration projects. The reason behind that perception is that new entrants face competition both from the formal incumbents and from the shadow firms, which have advantage due participation in informal activities, like tax evasion. Formal entry for a new firms is risky and costly, thus is not attractive. However, entry in informal economy may be even more risky and costly due to required additional expenditure on hiding economic activities, corruption and excommunication from public services and capital markets. Moreover, there is risk of becoming a victim of a criminal activity, such as organized rackets. Another potential concern for the newcomers in shadow economy is a so-called network capital, which is formed by unofficial incumbents for efficient cooperation instead of formal rules. Due to that, informal incumbents have advantage over the

newcomers simply by not allowing them to get their piece of pie. (Estrin & Mickiewicz 2010, 27.)

Researchers also regard the possibility of the opposite effect of large shadow economy on the substitution of the informal rules. They suggest that more widespread and embedded large shadow economy develops alternative informal set of norms for economic transactions, which are improved in comparison to those institutional arrangements present in shadow economy of a middle size. This suggestion corresponds to the observation of functionality of informal organizations in Peru provided by De Soto (1989). (Estrin & Mickiewicz 2010, 28.) Estrin and Mickiewicz explain this phenomenon by extended interests of shadow participants, which shaped informal systems of organized exchange due to appeared coherent expectations out of repeated behavior (Olson 2000; De Soto 1989 according to Estrin & Mickiewicz 2010, 28). Consequently, developed system of informal institutional arrangements may not restrain entrepreneurial entry. However, researchers note that findings in case of Peru may not be applicable for other countries. Thus, impact of shadow economy on the probability of entrepreneurial entry is negative. In addition, the researchers found that negative effect on entrepreneurship is lesser in economies with strong property rights. The reason for that is possibility to transfer activities from the informal back to the formal sector at initial phases. (Estrin & Mickiewicz 2010, 28.)

2.5 Shadow Economy and Corruption

Corruption is commonly defined as the abuse of public power for personal interests. World Bank (2009) characterizes corruption by distortion of the rule of law, oppression of the poor and undermining of the country's institutional foundation. Corruption includes illegal activities and impedes economic and social development. Thus, fighting corruption is extremely important to improve economic performance.

Corruption has numerous negative effects on the economy and social sphere. The first one is loss of institutional legitimacy that undermines

democracy due to orientation of institutional representatives towards personal advantage. The second is redistribution of scarce public resources from important public infrastructure projects (schools and hospitals) to high-profile projects. The third effect is distortion of competition. The fourth impact is development of general distrust toward political system and institutions, which allows appropriation of national assets by corrupt bureaucrats as a personal wealth.

Different types of corruption causes are recognized. Political and juridical causes are referred to the flaws of political system and include lack of political competition, low transparency of activities, weak and inefficient legal systems and degree of state decentralization. From social and cultural perspective, tradition in giving a gift in gratitude in combination with ignorance of population of governmental operations and own rights results in corruption. Economic reason for corruption is the extent of government interference with the economy and the size of public sector. Greater number of regulation, the same as large public sector, increase the bureaucratic power, hence, increase abilities to abuse that power for personal profit.

The main question in the relationship between corruption and shadow economy is whether they are substitutes or complements (Eilat&Zinnes 2002, 1235; Buehn& Schneider 2009, 2). Some studies believe that corruption is a substitute to unofficial economy. For example, Choi and Thum (2005) find that firm's decision to go underground limits the ability of bureaucrats for bribing. Presence of shadow economy alleviate problems of the official economy and thus, inhibits corruption. Thus, they concluded corruption and shadow economy to be substitutes. However, there is an opposite point view. Buehn and Schneider (2009, 4) apply model of unobservable variables for their study. They find that large shadow economy is associated with high levels of corruption. In countries with large underground activity, participants of informal sector often rely on bribing bureaucrats to avoid taxation, detection and punishment. Consequent reduction in quality of public goods and services drives more economic agents underground. Weak institutions and distortions in the

official economy increase corruption, which acts as an additional tax and pushes individuals toward the unofficial sector, hence increases shadow economy. Thus, corruption and shadow economy are considered complementary. (Buehn& Schneider 2009, 27-28.) Overall, the nature of relationship between unofficial economy and corruption remains unclear (Buehn& Schneider 2009, 2).

3 ENTREPRENEURSHIP

Evolution of the term “entrepreneur” started from French verb “entreprendre” in thirteenth century, meaning of which is to do something or to undertake. Appearance of the noun “entrepreneur” is referred to the sixteenth century. It was used to describe someone, who undertakes a business venture. In 1730 for the first time, an economist Richard Cantillon defined the main characteristic of the entrepreneur as a readiness to carry personal financial risk of a business venture. In early nineteenth century, the economists John Stuart Mill and Jean-Baptiste Say popularized academic use of the word completing its characteristics. Mill defined the entrepreneur as a person, who both bears the financial risks and management of the enterprise. Whereas Say defined the role of the entrepreneur in value creation via movement of resources from less to more productive areas. (Sobel 2008.)

Twentieth century ensured further development of the term through the works of the economists Joseph Schumpeter and Israel Kirzner. Schumpeter emphasizes the pioneering role of the entrepreneur in creation of new goods or production methods, thus provoking change in an economy. Entrepreneur is determined as a creative disruptive (destruction) force in an economy, which introduces beneficial methods and products based on the obsolescence and failure of others. On the other hand, Kirzner stresses the role of entrepreneurial discovery process, which reveals previously unnoticed profit opportunities. These profit opportunities will act on the market from the point of their discovery and implementation by the entrepreneur until market competition fully eliminates them. (Sobel 2008.)

The modern Austrian school of economics refined the definition of the entrepreneur (Sobel 2008.) From economic perspective entrepreneur is a recognizer of the unnoticed opportunities. In order to obtain and increase profit, entrepreneur continuously discovers new opportunities and seeks for innovations. Thus, entrepreneurial activity promotes more efficient

resource allocation on the market and development of the economy. (Boettke 2008.)

3.1 Types of Entrepreneurs

According to definition entrepreneur is a person who creates new combinations of resources in order to increase market value of these resources comparing to the already existing conjunctions of them or their separate usage. When the market value of the combination exceeds the value generated by other combinations, entrepreneur makes profit. However, the scale of profits are different from enterprise to enterprise. Thus, academic papers started arguing about composition of entrepreneurship. There is difference between self-employed housewife and Bill Gates, however, both are treated as entrepreneurs. Out of this uncertainty, types of the entrepreneurs appeared: lifestyle and gazelle entrepreneurs. Lifestyle entrepreneurs are the individuals, who start the businesses for nonmonetary reasons, mainly with the intention to manage their own schedule and be their own bosses. Gazelle entrepreneurs are controversially place a high value on monetary benefits and business growth. Gazelles implement one start-up business after another with an accurate growth plan and exit strategy. (Sobel 2008).

Similar types were defined for the start-ups. First type is life-style firms, which were opened in first place to support the owners. Firms of such type usually have very low growth potential and after several years may employ to 30 or 40 people. (Hisrich 2014, 41-42.)

Second type is foundation companies. Implementation of this type of start-up is based on the market research and aims development and growth of its market share. Foundation companies have higher growth potential than life-style firms, however in most of cases they stay private. In five or ten years, such company can grow from 40 to 400 employees. (Hisrich 2014, 42.)

Third type is high-potential venture or “gazelle” company. This type of business formation is characterized by extremely high growth potential. Due to this reason, gazelles usually attract great interest of investors. These companies could start as gazelles from the beginning either grow out of foundation companies. However, their growth is usually much faster and in five to ten years, they could employ around 500 persons. This type of companies is the most economically important for any area’s development. (Hisrich 2014, 42.)

3.1.1 Productive and Unproductive Entrepreneurship

Kizner (1997) states that entrepreneurs are seeking for opportunities for arbitrage and profit. Consequently, entrepreneurs are gravitated to the activities, which offer more of such opportunities. It is widely recognized that choice upon the direction for the entrepreneurial activity pursuing profit opportunities depends on prevailing economic and political institutions. (Sobel, Clark & Lee 2007, 222.)

When institutions provide security of property rights, balanced and unbiased juridical system, contract enforcement and restrictions on wealth transfers by the state through regulations and taxation, it is more likely that entrepreneurial activity will concentrate in the private sector, recognizing more opportunities on the market. Private entrepreneurship is a key source of new ideas and technologies, new goods and services, which result from competitive pressures and natural wish to maximize the profit. Therefore, private entrepreneurship is referred to a productive entrepreneurship. (Sobel, Clark & Lee 2007, 222.)

Another direction for the entrepreneurial activity is political or unproductive entrepreneurship. In case institutions are poor, entrepreneurs recognize more opportunities in participating the process of transferring existing wealth through lobbying, rent-seeking and corruption. In such situation, more entrepreneurial efforts are directed towards gaining government favors and protection instead of wealth creation on the market. However, it is also recognized that in developed economies though they are relying on

the economic freedom, political entrepreneurship is usually a complementary to the successful private entrepreneurship due to the intention of the latter to protect its position from the threat of competition. (Sobel, Clark & Lee 2007, 222.)

3.2 Nature of Entrepreneurship

North (1997a) denoted companies set up by entrepreneurs, as the main agents of change (Aidis, Estrin & Mickiewicz 2010, 4); Schumpeter (1942) referred entrepreneurs to a “disruption force”; Kizner named entrepreneurs as opportunity-seekers (Sobel 2008). All these characteristics and nature of entrepreneurship mentioned by the economists are referred to the entrepreneurial spirit, which was described by Adam Smith about 200 years ago. He specified that people had natural inclination to the exchange and barter, which was present in everyone and represented a primary entrepreneurial spirit (Sobel 2007, 222). Although every person has a primary intention for entrepreneurship, it is obvious that not everybody are entrepreneurs or will ever become them. This obviousness shows that individuals called entrepreneurs, though they have the same natural intention to the exchange, differ from majority of people. These differences became of particular interest to the researchers and policy makers due to significant economic importance of entrepreneurship especially in terms of market economy.

To investigate specific characteristics of entrepreneurs and conditions enabling appearance of these characteristics, the process of becoming and performing as entrepreneur is widely studied by researchers in different scientific areas. Such process received the name of entrepreneurial process. FIGURE 3 represents general entrepreneurial process model developed for this study.

Although most authors develop their own unique model of entrepreneurial process depending on scientific perspective and research purposes, two main phases can be distinguished. The first phase is “silent” or latent. It involves recognition of the opportunity and formation and development of

entrepreneurial intention. The second phase of the process represents entrepreneurial actions and their output. Each phase is constituted by inner stages, which may vary from study to study. Thus, the most widely recognizable stages within silent phase are recognition, preliminary exploitation of the opportunity and triggering event forming intention for the opportunity design. Active phase include design of the opportunity (implementation) and growth of the business (Leutner et. al 2014, 58; Nassif, Ghobril& da Silva 2010, 215-216; Nadram and Samson (2008, 64).

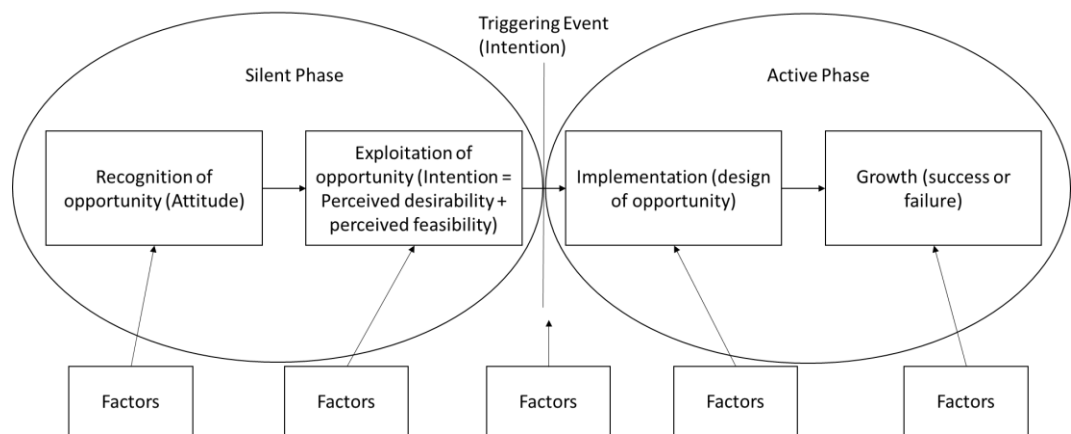


FIGURE 3. Entrepreneurial Process Model (General)

Although stages of entrepreneurial process illustrate steps taken towards business formation and development, where triggering event is a breaking point, another important part of the entrepreneurial process model is factors enabling performance of each process stage (Nassif, Ghobril& da Silva 2010, 215-216). The effect of factors on the entrepreneurship is explained in the next section.

3.3 Factors Enabling Entrepreneurship

In pursuit to clarify determinants of entrepreneurship researchers explored wide variety of existing factors and underlining complexity of their interrelations. Although factors are categorized differently in every entrepreneurial process model mainly two groups are distinguished: personal traits and environmental or contextual factors. Whereas personal factors according to the name are internal individual characteristics of a person, environmental factors represent external conditions of the particular environment, affecting individual, such as economy, politics, culture, resources and so on. (Yan 2010, 2; Nassif, Ghobril & da Silva 2010, 216.)

As was mentioned earlier, factors are more or less interacting and interrelated between each other and right combination of them enables particular stage of entrepreneurial process. Thus, particular factors shape individual's ability to recognize business opportunity, other form personal attitudes towards this opportunity, whereas another group of factors influences the probability of entrepreneurial success or failure. (Yan 2010, 2; Nassif, Ghobril & da Silva 2010, 216.)

One of the central points in factorial modeling takes the concept of perceived desirability and perceived feasibility of new business venture, which determines formation of the following entrepreneurial intention, hence, probability of market entry. Thus, personalities with high perceived desirability are found to form entrepreneurial intention even if perceived feasibility is low, whereas individuals with low desirability, if feasibility is also low, tend to refrain from intentions (Brandstätter 2010, 7). Therefore, factors can be also sub-divided into two more groups, as those affecting desirability and feasibility of entrepreneurship. Moreover, specific factors in a particular situation or at specific process stage can be more important than the other ones.

A good example of interdependency between factors and its affection on entrepreneurial intention through desirability and feasibility is situation

described by economists Estrin and Mickiewicz (2010, 14-15).

Researchers state that willingness to enter the market mainly depends on the attitudes of potential entrepreneurs. This refers to the individual's confidence and readiness to accept the risk of failure. Confidence in own skills (self-efficacy) is related to the level of education and character of the individual (personal traits) and may affect the entrepreneurial decision-making process. (Estrin & Mickiewicz 2010, 14-15.) Willingness to accept the risk of failure may depend on the general uncertainties and confidence in economic stability. Thus, the greater is uncertainty of a future day, the less entrepreneurs will decide to enter the market. Uncertainty may depend on the institutional aspects, like security of property rights and corruption. (Estrin & Mickiewicz 2010, 18-20.) This example perfectly describes the situation, when entrepreneurial intention should move to the implementation stage, however rather weak desirability, assured by personal traits, in combination with weak perceived feasibility, assured by environmental factors like economic stability, hinders entrepreneurial intention.

Due to the great number of factors, this study observes only main theoretical perspectives such as psychological factors, social factors and institutional perspective focusing on the concept of economic freedom.

3.3.1 Psychological Factors and Personal Traits

Studies with psychological perspective mainly observe personal traits and their impact on the process of entrepreneurial entry decision-making and on the probability of success or failure of a new venture.

One of the cornerstone theories in studying psychological factors predicting entrepreneurship is Five-factor model (FFM), which is a prevalent reference system for personality traits. Big five traits include Extraversion, Conscientiousness, Openness, Agreeableness and Neuroticism (reverse Emotional stability). Extraversion is characterized by activity, sociability, positive emotionality and assertiveness.

Conscientiousness is referred to a socially prescribed goal-directed

behavior. Openness describes readiness to a new experience measured on the depth, complexity and originality of present individual's experience. Agreeableness is related to communal and prosocial orientation and includes such weighted traits as trust, altruism, tender-mildness and modesty. Neuroticism deals with negative emotionality and is characterized by anxiousness, sadness and tension. (Brandstätter 2010, 5-6.)

Although the FFM shows high association between personality and entrepreneurship in both early and recent studies, significant amount of researches find inconsistency of their influence and the strength of the affection on the probability of entrepreneurial entry or success in different contexts. For instance, Bipp, Steinmayr, and Spinath (2008) show that significant number of achievement motivation model aspects, where achievement motivation model includes performance approach goals, learning goals, performance avoidance goals, and work avoidance goals, correlate both with the FFM's global scales and its facets. The highest positive correlations, as one would expect, are found between Openness and learning goals and Neuroticism and performance avoidance goals, whereas Conscientiousness and work avoidance goals has the highest negative score. (Brandstätter 2010, 2.) At the same time, study that is more recent finds that Extraversion and Conscientiousness scores do not show statistically significant difference in comparison between managers and entrepreneurs thus cannot directly influence entrepreneurial entry (Barclays 2015, 5). The issue for investigation of entrepreneurial personality with the FFM's global scales is commonality of scales themselves, whereas weighted traits of each scale are particularly important. Moreover, FFM do not include all personality aspects. Therefore, researches started to apply other personality constructs, which include locus of control, static VS active orientation, self-efficacy and other. Nadram and Samson (2008, 57-64) investigate psychological factors affecting entrepreneurial process through behavioral attributes, state VS active (part of achievement motivation theory), promotion VS prevention orientations active (part of achievement motivation theory) and

mood regulations. They assume the model, where cognitive (promotion VS prevention orientations), emotion (state VS active orientations) and mood (or mental fitness: self-confidence, tension, energy, alertness and satisfaction) orientations form specific behavioral attributes (based on the FFM) and affect individual's attitude towards opportunity, the same as intention and self-efficacy to design the opportunity. The authors find that promotion orientation, action orientation, self-confidence, low tension, energy, alertness and satisfaction shape necessary behavioral attributes for the entrepreneurship. Behavioral attributes of an entrepreneur, which are developed from weighted facets of the FFM's scales, include drive to achieve, assertiveness, hardiness, awareness of opportunities, trust, integrity and flexibility. Both behavioral attributes and their constitution orientations have positive effect on the entrepreneurial attitude, self-efficacy and entrepreneurial intention. (Nadram and Samson 2008, 57-64.)

Other commonly mentioned entrepreneurial personal attributes except Big five factors are risk propensity, need for autonomy, locus of control, initiative, innovativeness and self-efficacy (Barclays 2015, 5; Brandstätter 2010, 3). All these factors show statistically significant positive differences between scores gained by entrepreneurs and managers respectively, whereas Agreeableness and Neuroticism score differences are negative (Barclays 2015, 5). However, not all of them are found to have positive effect on both entrepreneurial intention and entrepreneurial success. Thus, higher risk propensity increases likelihood of entrepreneurial entry but if excessive may decrease probability of entrepreneurial success (business growth), especially in case of low Consciousness (Brandstätter 2010, 5). Moreover, the importance of a particular personal trait varies between entrepreneurs of different sectors and countries (Barclays 2015; 6-7, 10-11). Such results shows that personal traits are not independent from the contextual factors and probably from each other.

3.4 Social Factors

While as many studies are investigating psychological and economic factors determining entrepreneurship, the influence of social and cultural factors on the phenomenon remains understudied (Thornton, Ribeiro-Soriano & Urbano 2011, 106). However, the idea of social and cultural influence is not new.

Social theories suggest that the dynamics of economy are socially embedded, therefore entrepreneurship is toughly connected with social capital and social network. Social capital is the concept defined as tangible and intangible resources that contribute to achieving actor's goals and that occur to the actors through social structure. In other words, social capital is a set of resources that is embedded in relationships. (Burt 1992 according to Thornton, Ribeiro-Soriano & Urbano 2011, 107.) One of the valuable resources within the social capital concept is considered network of relationship. Taking into account that entrepreneur is the actor, who collects entrepreneurial ideas and resources to implement and develop them, it is possible to assume that entrepreneurship and its outcomes are shaped under social morals and illicit norms. Within this context Portes and Landolt (2000) distinguished several negative consequences of social capital such as excess requirements on group members, restrictions on the individual freedom, exclusion of the outliers and deterioration of norms (Thornton, Ribeiro-Soriano & Urbano 2011, 107-108). These consequences are claimed to lead to inequality of resources available for entrepreneurs e.g. of different ethnic groups, countries or regions (Thornton, Ribeiro-Soriano & Urbano 2011, 108).

Social network is another concept related to the access of the entrepreneurial resources, specifically those possessed externally. Social network is defined as a set of relations between actors shaping perceptions of a community. The underlying idea of the relation between the concept and entrepreneurship is that necessary resources for business creation owned by entrepreneur are limited, therefore there is a need to obtain complementary resources through his/her social contacts. In

entrepreneurship network studies, three streamlines for investigation are prevailing: the nature of subject for the exchange between actors (e.g. intangible resources and social capital), governance mechanisms in relations (e.g. trust between partners) and network structure created by the actors' relationships. (Thornton, Ribeiro-Soriano & Urbano 2011, 108.)

Literature also states the cultural influence on the entrepreneurship. One of the main assumptions is that new business is created in a specific cultural environment and, therefore, it reflects the characteristics of that cultural environment via grounding business activities on embedded cultural norms and values. (Thornton, Ribeiro-Soriano & Urbano 2011, 109.)

Thus, among prevailingly mentioned social factors are named culture, sub-culture, ethnics, family and entourage of the individual, which form social network and social capital.

3.5 Economic and Political Factors (Institutional Theory)

Role of entrepreneurship in economic development is widely recognized by the governments today, so they try to identify factors, which will encourage massive entrepreneurial entry. (Aidis, Estrin & Mickiewicz 2010, 3.) As was argued earlier, Adam Smith specified that people have natural inclination to the exchange, thus everyone possesses a primary entrepreneurial spirit (Sobel 2007, 222). Thus, the question is what can promote the intention and decision to enter the market.

Many studies emphasize the role of government in the entrepreneurial decision process. Formal institutions are particularly important at this stage. (Aidis, Estrin & Mickiewicz 2010, 2.) Government policy can influence the rate of entrepreneurship through two separate channels. The first channel implies quality and quantity of economic inputs and resources directed into the entrepreneurial process that are further turned into entrepreneurial outcome. The examples of such inputs are education, government subsidies, availability of a venture capital and tax relief.

Government policy can increase the ingoing inputs and thus to promote the ability to undertake a new business venture. The second channel is referred to the rules of game determined for the entrepreneurs through the institutional structure. Broadly, institutional framework defines the incentive and reward structure for economic agents within an economy. Examples of the second channel are policies relative to security of property rights, legal system, constraints on state's interference and market regulations. The entrepreneurial outcomes that are generated from the available resources and economic inputs are mainly dependent on a public policy. Thus, it is more favorable to revise the institutional framework than just to increase the amount of resources available. (Sobel 2007, 222; Hall & Sobel 2006, 5.) The entrepreneurial process (economic perspective) is illustrated by Figure 4.

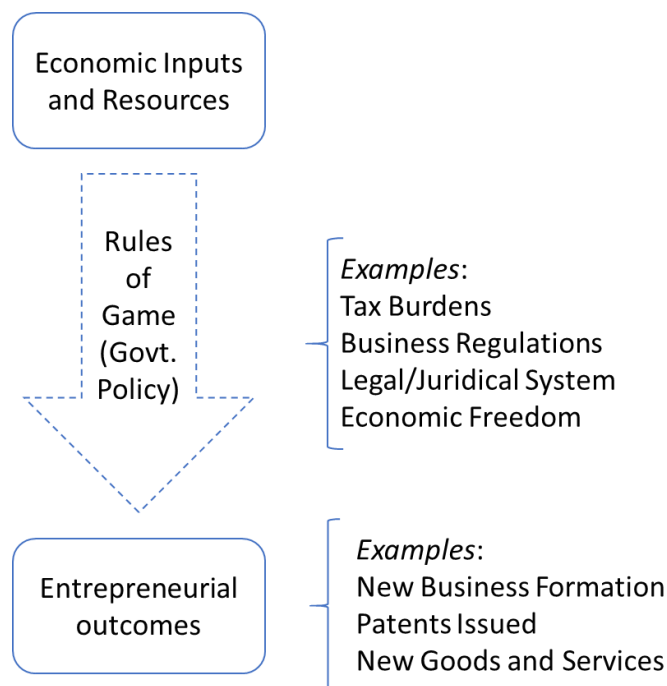


FIGURE 4. The Entrepreneurial Process (Sobel & Hall 2006, 5)

3.5.1 Economic Freedom

While regarding impacts of institutions on the entrepreneurial process, it is important to understand that institutional framework determines also

framework for actions of economic agents. Economic researches have showed that public policy of economic freedom provides the best conditions for the economic agents and, hence, best promotes entrepreneurship. Such economic policy is provided by specific legal structure and law-enforcement system, which are focused on the protection of owners' property rights, unbiased enforcement of contracts, freedom of personal choice, voluntary exchange, and freedom to enter and compete in labor and any product markets. Freedom of economy reduces when government interferes mentioned areas by setting regulations and restrictions that in core unavoidable. Therefore, to measure how far the particular economy is from absolute economic freedom, prevalently Index of Economic Freedom provided by The Heritage Foundation is applied. Research of Steven Kreft and Russel Sobel (2003) revealed positive relationship (correlation) between Economic Freedom Index and Index of Entrepreneurial Activity. This positive relationship becomes stronger, when other socioeconomic and demographic factors are under control.

The model of Economic Freedom Index includes measurement categories such as rule of law, efficiency of regulations, government limitations and openness of markets. Each of the four categories involves several measurements. Any of the aspects measured can have positive or negative influence on the entrepreneurial activity depending on its sufficiency.

Limited government is associated with the fiscal freedom and government expenditure. Fiscal freedom describes the tax burden imposed on economic agents. It observes marginal income tax rates for individuals and private sector, and total tax burden that includes all kinds of direct and indirect taxation imposed as a percentage of GDP. Government expenditure is referred to how much state is spending on both consumption and transfers as a percentage of GDP. No ideal level is found for the government expenditure making it variable on the country and country's economic context. However, excessive expenditure, which causes constant budget deficit and increase in sovereign debt, is

proved detrimental for any economy's development. (The Heritage Foundation 2016.) In context of promotion entrepreneurial activity, early researches supposed that government programs aimed to provide financial and educational support would help to promote entrepreneurship. Such programs included government-managed loan funds, funded business development centers, subsidies and implementation of entrepreneurial curriculum in public schools. However, most of the programs, especially financial ones, proved themselves ineffective or less effective than was expected. The main reasons for inefficiency were poor incentives, bureaucracy and political pressures common for many state agencies. Furthermore, economists find that venture capital funding does not necessarily encourages entrepreneurial activity. Due to natural capital mobility, it is gravitated to the creative and potentially profitable ideas. Thus, the promotion of the entrepreneur and ideas is more contributing to the economic development than attraction of the risk- capital at the primary stages. (Sobel 2008.)

Open market category includes measurements of trade, investment and financial freedom. Trade freedom is associated with the restrictions and barriers imposed on trade, particularly with the tariff and non-tariff barriers influencing imports and exports. Non-tariff barriers according to The Heritage Foundation (2016) include six groups of restrictions. They are *quantity restrictions* (import& export embargoes; import quotas; export restrictions etc.), *price restrictions* (countervailing duties; other various tariffs/levies; antidumping duties etc.) and *regulatory restrictions* (sanitary standards; licensing; industrial and safety standards; advertising regulations; labeling, packaging and trademark regulations etc.). Other three groups of non-tariff barriers are *investment regulations* (barter and any other financial controls), *customs restrictions* (customs clearance; valuations and classification procedures; deposit requirements etc.) and *direct government intervention* (competition policies; government trading, state monopolies; various technology and industrial policies; subsidies etc.). Presence of any of these barriers reduces trade freedom and complicates operations for economic agents (incl. entrepreneurs), limiting

their ability to choose and increasing costs of operations. (The Heritage Foundation 2016.)

Investment freedom measures the constraints and restrictions on the flow of investment capital, i.e. ability of economic agents to move their resources freely into specific activities and out of them both within national economy and abroad without any restriction (The Heritage Foundation 2016). Investments are one of the main financing sources for enterprises, thus high ability to move and redirect resources from activity to activity increases chances for business ventures to gain required funds. Hence, the more restrictions, the less attractive it is to invest and the less likely it is to get needed capital for enterprises.

Financial freedom describes the efficiency of banking sector and level of government interference into it. Free financial sector is the one, in which independent central bank supervise other financial institutions and regulations are limited to contract enforcement and prevention of fraud. Within free financial sector, credit allocation is not controlled by the state and occurs according to market requirements. Furthermore, financial institutions are not restricted in variety of services they provide to individuals and enterprises the same, as they are free to conduct operations in any foreign currency. Financial market is opened to foreign financial institutions, which are treated equally as domestic ones. Government control is limited and state does not interfere the sector through direct or indirect ownership of the financial institutions. If financial freedom is restricted and institutions are highly controlled, competition will be limited, hence, market development is restrained, as the variety, quality and availability of services are hardly improving. (The Heritage Foundation 2016.) That consequently affects ability of private organizations to obtain funds.

Regulatory efficiency consists of the business freedom, labor freedom and monetary freedom. Business freedom measures the overall burden of regulations and efficiency of the state in the regulatory process. These two aspects reflect the ability and easiness of procedures to open, operate and

close the business, meaning the overall expenditure of time and money on the processes. Labor freedom represents the regulations and laws on the labor market determining its flexibility, such as minimum wages, working hours, dismissal rules and so on. Monetary freedom is the measurement representing the price stability and price control, namely inflationary pressure and state control over the prices distorting activity on the market. (The Heritage Foundation 2016.)

Rule of law embraces security of property rights and freedom from corruption. Security (insecurity) of property rights defines the individuals' ability to cumulate private property and level of its security provided by the laws that are enforced by government. Assessment of security of property rights is based on the extent to which laws are protecting it and extent to which the state enforces these laws, including probability of property expropriation, independence and corruption of judiciary and ability of contract enforcement by the parties. Freedom from corruption measures the extent of the corruption existing in the country. (The Heritage Foundation 2016.)

Institutional theory based on the idea of economic freedom is widely recognized in the literature. Various studies investigate relationships between determinants of economic freedom and entrepreneurial activity. Thus, Aidis, Estrin and Mickiewicz (2010) focus on the government size, freedom from corruption, security of property rights and market regulation; Klapper, Laeven and Rajan (2004) investigate impacts of entry regulations and financial freedom; Van Stel et. al (2005) study government interference through labor flexibility, social security expenditure and entry regulations and there are much more studies can be found.

Effects of economic freedom determinants on the entrepreneurship are two-sided, meaning they may both promote and hinder entrepreneurial activity. If there are secured property rights, unbiased and balanced juridical system, enforcement of contracts, and efficiently limited ability of the state to relocate wealth through taxes and regulations, likelihood of entrepreneurial entries increases. In contrast, unsecured property rights,

excessive taxation and regulation, and unfair juridical system restrain entrepreneurial activity. However, that is true only for productive entrepreneurship. While as poor institutions decrease opportunities in the private sector, they simultaneously create new opportunities in public sector, thus, inclining creative individuals towards unproductive, political entrepreneurship. (Sobel, Clark & Lee 2007, 222.)

Sobel, Clark and Lee (2007) in their study describe the theory that active entrepreneurs at some point find that enhancement of entry barriers is now beneficial to them. They refer to the definition of Schumpeter (1942), that entrepreneurship is a disruptive force. Firm that cannot compete and finally goes out of business from economic point of view can be seen as a positive occasion, as failure of the firm frees up the engaged resources for a more efficient use. However, the individuals within firms, which earn losses, barely perceive the failure in a positive way. Great competition and risk of failure may persuade individuals to lobby the government for the restriction of the competition they face. The entrepreneurs that succeeded from the freedom of entry in the first place, now find limitation of this freedom more beneficial. (Sobel, Clark & Lee 2007, 225.) Clark and Lee (2006) describe the situation, where freedom of entry can be limited not because of the entrepreneurial failure but due to the success. In over politicized economies, where government acts on the behalf of the interest group, successful entrepreneurs may lobby for the policies that protect them from the new or potential competition. (Clark & Lee 2006 according to Sobel, Clark & Lee 2007, 225.) The conclusion can be made that without proper constraints the lobbyists and interest groups will influence politicians. This will result in the legislation acting in the interests of these narrow groups at the expense of the general taxpayer or consumer. Thus, impartiality of the state is a necessity for the economic freedom and freedom of entry in particular. (Sobel, Clark & Lee 2007, 225.)

Although, in case of low economic freedom entrepreneurial activity does not disappear entirely but transfers, unproductive entrepreneurship does not create new wealth. Moreover, it negatively affects resource allocation and hinders innovations. Therefore, massive political entrepreneurship

slows down economic development, deteriorates economic performance and international competitiveness of the country.

3.5.2 State's Impartiality

Sobel, Clark and Lee (2007) in their study describe the theory that active entrepreneurs at some point find that enhancement of entry barriers is now beneficial to them. They refer to the definition of Schumpeter (1942), that entrepreneurship is a disruptive force. Firm that cannot compete and finally goes out of business from economic point of view can be seen as a positive occasion, as failure of the firm frees up the engaged resources for a more efficient use. However, the individuals within firms, which earn losses, barely perceive the failure in a positive way. Great competition and risk of failure may persuade individuals to lobby the government for the restriction of the competition they face. The entrepreneurs that succeeded from the freedom of entry in the first place, now find limitation of this freedom more beneficial. (Sobel, Clark & Lee 2007, 225.) Clark and Lee (2006) describe the situation, where freedom of entry can be limited not because of the entrepreneurial failure but due to the success. In over politicized economies, where government acts on the behalf of the interest group, successful entrepreneurs may lobby for the policies that protect them from the new or potential competition. (Clark & Lee 2006 according to Sobel, Clark & Lee 2007, 225.) The conclusion can be made that without proper constraints the lobbyists and interest groups will influence politicians. This will result in the legislation acting in the interests of these narrow groups at the expense of the general taxpayer or consumer. Thus, impartiality of the state is a necessity for the economic freedom and freedom of entry in particular. (Sobel, Clark & Lee 2007, 225.)

3.6 Other Factors

Different factorial theories (psychological, social, institutional) described can provide more interactive entrepreneurship process model than if each group of factors is observed separately. Although study concentrates on

the investigation of large theories, it does not ignore other important and commonly mentioned factors, which directly and indirectly may influence execution of each process stage, such as personal factors, demographic factors, and managerial (organizational) factors. Thus, among personal factors, which originally include psychological factors, there are such factors as job dissatisfaction, job loss, education, age, work experience, skills and so on (Nassif, Ghobril & da Silva 2010, 216). Demographic factors may be regarded as an extended social factors and include ethnical groups, region, country, culture and sub-culture, religion and so on. Categorization of factors is nominal and, therefore, different studies refer one factor to different categories. Managerial or organizational factors related to an implemented business venture include such factors as vision, strategy, team, managerial efficiency and so on (Nassif, Ghobril & da Silva 2010, 216).

Some studies also consider other environmental factors. Thus, research, which investigates economic and institutional factors affecting entrepreneurial intention within Spanish Autonomous Regions has found significant positive correlations between perception of opportunities and GDP per capita and inflation, whereas market dynamics and unemployment have negative correlation with entrepreneurial intention (Vidal-Suñé & López-Panisello 2013, 86). Another additional factor that is commonly mentioned is competition (Nassif, Ghobril & da Silva 2010, 216; Estrin & Mickiewicz 2010, 27).

3.7 Entrepreneurial Process Model

Factors influencing entrepreneurial entry and success, which are described in previous sections, are not independent but they interact between each other. Moreover, depending on the context particular group of factors or specific factor itself may gain higher level of importance while affecting each stage of entrepreneurial process. Thus, recognition of the opportunity is more dependent on personality traits (psychological factors) and experience of an individual. However, at the same time recognition

stage is indirectly affected by social factors, as personality traits and experience (personal trait, which is different from personality trait) are developed within society and, therefore, dependent on the social context (e.g. culture, entourage, social networks).

Exploitation of the opportunity, including perceived desirability and perceived feasibility, is shaped by psychological, social, economic and political factors. While as desirability is mainly affected by personality traits, individual's system of values, motives and social context, perceived feasibility depends on the economic resources and their accessibility, political (or institutional) framework, social capital and network, individual's degree of expertise, awareness, opportunism and other personality traits. As the importance of each group of factors varies in dependence with the other ones, if individual has all necessary personality and personal traits and favorable social context, which ensure his/her self-efficacy and desirability, economic and political factors have lower influence on the probability of entry. In contrast, if individual lacks some personality and personal traits forming his/her self-efficacy and high desirability of a new venture, influence of economic and political factors increases.

At the implementation stage, which is also affected by psychological, social, personal and institutional factors, economic and political factors may be regarded as the core ones. However, if institutional environment is unfavorable, social factors (social capital and social network) become more important. Within the factorial group, there is also variability between the factors, which are important for a particular process stage. Thus, some of the personal attributes and some of the psychological factors become more important for the execution of implementation stage, such as experience, education and skills for the personal factors and achievement motivation, risk propensity and emotional stability for the personality traits. The same groups of factors also influence the growth stage (success or failure).

4 CONNECTING SHADOW ECONOMY AND ENTREPRENEURSHIP

Theoretical investigation of the shadow economy as a concept has recognized that phenomenon is defined in connection to the institutional and legal framework, which determines formality and legality of the economic activities. Excessive regulations and restrictions imposed on the economic activities promote informal economy. That fact relates shadow economy to the concept of Economic freedom and allows predicting negative correlation between them. Thus, if economy is mostly free it is possible to expect small shadow economy, whereas in highly controlled unfree economies presence of large informal sector is supposed.

Relation of shadow economy to economic freedom links it with entrepreneurship. If large shadow economy is present, it signals about significant problems within institutional framework. Therefore, expected level of entrepreneurial entries the same, as engagement in entrepreneurship should be relatively low. However, that is usually referred only to officially recorded start-ups.

Creative individuals continuously recognize new opportunities and seek for their execution. If official economy cannot be used for the opportunity implementation, the alternative informal sector may be chosen. Another alternative for the profit-seeking entrepreneurs is political entrepreneurship, which in case of overregulation and oversized government is more attractive than productive (private) one. Thus, it is possible to estimate a logical chain, in which poor institutions promote growth of unofficial sector and biased government partially through pushing entrepreneurs into shadow or to unproductive activities that cause further deterioration of institutions. Within unchanged institutional context, effects of growing shadow sector on country's economy may become dynamic and result in a vicious circle (Schneider & Williams 2013, 39), the same as bad economic equilibrium described by Johnson, Kaufmann and Zoido-Lobaton (1998a, A45).

Interrelation of shadow economy and institutional framework is not one-sided but in dynamic is two-sided. While as formal institutions affect shadow economy, shadow economy through effects on economic environment influences development and performance of public institutions back. Therefore, regarding entrepreneurship as an entity that exists within and shapes specific economic and institutional environment, it is necessary to observe main aspects of that environment. Taking for a base the policy of Economic freedom, these aspects include security of property rights, freedom from corruption, government spending, fiscal freedom, business freedom, labor freedom, monetary freedom, trade freedom, investment freedom and financial freedom. Besides the focus on aspects of Economic Freedom, it is required to account social factor due to natural embeddedness of economic activities into social sphere. Thus, while regarding the effects of shadow economy, its influence on the social norms and institutions is important. If large long-lasting shadow economy is present, it promotes formation of a new set of informal institutions (meaning here: norms), which become a substitute for the formal ones. Embeddedness of new informal institutions means changed through the social networks social morals and individuals' system of values affecting perception of the opportunities and entire entrepreneurial process. The dominance of informal institutions over the formal ones increases value of social capital and its possible negative consequences (excess requirements on group members, restrictions on the individual freedom, exclusion of the outliers and deterioration of norms). Moreover, increased value of social capital complicates transition from the informal sector back to the official economy (Eilat&Zinnes 2002, 1236).

Any excessive institutional regulations and especially restrictions are claimed to cause shadow economy (Schneider & Williams 2013, 38). These include restrictions of trade freedom, business freedom, labor freedom, monetary freedom, investment freedom and financial freedom. The issue is that over-regulations and restrictions in any of these aspects increase cost of production and reduce profit opportunities for economic agents. Therefore, those operators, who are not able or unwilling to bear

increased costs and to reduce profits, have mainly two options: to leave the market or to operate unofficially. Although in case of each aspect of Economic Freedom the economic agents' stimuli (to make and increase profit) and choice options are the same, it might be important to focus on their process of decision-making and its output in every particular case.

Thus, if to observe trade freedom, over-regulations and restrictions not only on international but also on domestic trade create and increase time and money costs, complicating operations for economic agents and decreasing the attractiveness of business activities for potential newcomers (for example from employees within sector). Although trade regulations and restrictions are necessary and unavoidable, as they determine and unsure level of quality and safety of goods traded, the same as adjust competition on the domestic market and serve as government's funding source, the excessive number of them proves themselves inefficient in core. Inefficient regulations have to be covered and supported by other regulations, which have to be controlled and supported by specific institutions and other regulations, which also have to be controlled and supported and thus to the eternity. Such excessive regulations, for example in trade, provoke not only transfer of private business into shadow, but also create place for corruption through oversized government, hence, inefficient and excessive government expenditure, chronic budget deficit, increased tax burden, inflation and depressed undeveloped private sector lacking competition.

Fiscal freedom represents complexity of tax system and overall tax burden laid on the economic actors. High taxes and simple tax system, which decreases opportunity to reduce tax burden legally, make economic agents to hide their activities and income in order to save profits participating in unofficial sector. Tax burden was also found a factor decreasing official entrepreneurial entry, the same as progressivity of taxes has discouraging effect on entrepreneurial intention (Gentry & Hubbard 2005, 104).

Fiscal freedom is highly connected with a labor freedom, which represents availability and cost of labor. Thus, if taxes paid by company on labor are high, firms are rarely interested in hiring additional labor. The same issue arises if such labor regulations as minimal wage dictates high level of wages to be paid. Therefore, hiring is usually done unofficially if it is additional labor force, whereas permanent employment may be done with hidden real income of the employee. As employers represent demand side and employees are supply side of work force, the latter usually take offered employment conditions due to the difficulty in obtaining job in present environment and especially if personal income tax is either high. Thus, it might be assumed that labor regulations are rarely the issue hindering entrepreneurial entry but they are the issue for the firm's development. The paradox is that excessive labor regulations, which are aimed to protect employees, improve working conditions and increase standard of living, cause increase in unemployment and, thus, push massive share of job-seeking population to the unofficial sector leaving them legally unprotected. Employers, who participate shadow economy, thus get access to rather cheap and less problematic labor, which usually cost less than other methods and tools replacing human involvement and increasing efficiency of operations. The result is that firms using informal labor rely on labor-intensive operations usually at the expense of efficiency loss (Eilat&Zinnes 2002, 1237).

Business freedom, which represents easiness and costs of market entry and exit, is the issue for newcomers' decision-making. If the process of business registration is time-consuming and costly, while there is option to participate unofficial sector, an individual may incline to informal entry. Possibility especially increases if besides complicated process of entry there are other significant restrictions on the firm's operations.

One more potential concern for entrepreneurs is price stability, which represented by monetary freedom and determined by inflation and price controls. In case of instable national currency, economic agents are assumed to start transactions in any other currency or barter, thus promoting unrecorded activities (Eilat&Zinnes 2002, 1242). Another option

is that economic agents will try to stabilize increase in prices through decrease in production costs achieved by transferring operations into shadow economy. Although one study has found positive correlation between inflation and entrepreneurial intention (Vidal-Suñé&López-Panisello 2013, 86) that may be a non-linear relationship. Inflation rate increases with the increase in economic performance. Thus, gained result by Vidal-Suñé and López-Panisello (2013, 86) might be the evidence of economic growth, which promotes and is promoted by entrepreneurship. However, high and consistently rising inflationary pressures evidence about significant economic problems. In such cases purchasing power and demand decreases, number of firms on the market decreases and unemployment increases. Within that environment, rare entrepreneurial entry can be expected especially in official sector. Price controls also distort market activity, as they impede establishment of “natural” price equilibrium on the market. Thus, the distortion promotes informal activities and hinders formal entrepreneurial entry due to intention to avoid undesirable regulation.

Obtainment of capital for establishment and development of business venture is one of the greatest challenges for the entrepreneurs, especially if financial and investment freedoms are low. The extent of regulations laid on financial services, state’s intervention in the market through direct and indirect ownership of financial institutions, overall development of financial and capital markets, extent to which government influence the allocation of credit and openness to foreign competition determine financial freedom. These five broad areas affect availability of financial resources and simplicity of accessing them for private business. Therefore, the lower is financial freedom the harder it is to obtain necessary capital for the entrepreneurs. Another common source of capital is investments. However, if flow of investment capital is highly restrained, hence, the possibility to get those decreases. Difficulty in obtaining capital for business establishment or for growth projects restrains entrepreneurial entry and performance. It also negatively affects entrepreneurial intention, decreasing perceived feasibility of a new venture. Although individuals,

who decided to start or continue operations of the firm can rely only on own-financing and on resources provided through social capital. Hardly accessible capital and own-financing solely cannot afford large investments required for business growth, whereas make firms to focus on a short-term (Kaufmann & Kaliberda 1996, 27; Eilat & Zinnes 2002, 1237). Such situation is typical for the shadow firms either, thus making no difference for the entrepreneur to operate officially or to participate unofficial sector, while as short-term orientation increases attractiveness of the shadow economy due to its benefits over official economy (tax avoidance, cheaper labor etc.). Moreover, inaccessible capital in both official and unofficial sectors limits ability of entrepreneurs to participate in sectors that require substantial financial inputs, whereas relatively more profitable shadow economy may attract newcomers to the sectors amenable for it (trade, construction etc.). Thus, unavailability of capital and shadow economy cause inefficient resource allocation and uneven development of economic sectors. Finally, taking into account social embeddedness of economic activities it is possible to assume that entrepreneurs both active and potential then start to find more opportunities within "shadow" sectors and mainly ignore the other ones.

One potential source of funding for entrepreneurs are governmental subsidies and loans, which are the part of government spending (part of Economic Freedom Index). Although Sobel (2008) mentions that programs providing government-managed loans suffer from bureaucracy and political pressures, their absence deprives another source of finance for a new ventures. Considering other government spending, low government expenditure on infrastructure and institutional efficiency has depressing effect on private business and may end up in business shift to the informal sector. At the same time, consistent state's consumption and transfers into the same areas may reduce the size of shadow economy. However, significant transfers to the social welfare system are one of the reasons for shadow economy increase. For example, high unemployment benefits may push potential workers to the informal employment, thus receiving non-taxable salary and unemployment benefit simultaneously. High level

of benefits are also associated with substantial tax burden laid on private business and employed individuals inclining them to avoid taxes. The last issue related to government spending is that excessive government expenditure accompanied by chronic budget deficits and increase in sovereign debt is even more threatful for economic dynamism than the small one (The Heritage Foundation 2016).

Over-regulations restricting freedom of economy are the result of institutional inefficiency, which is the main cause and then the effect of shadow economy. Secure property rights are the core base for Economic Freedom and important sign of effective institutions. Security of property rights, which is ensured by clear legislation and unbiased independent judiciary enforcing these laws, is the cornerstone of market economy. Highly secured property rights guarantee that individual's property will not be expropriated, hence motivates to perform economic activities officially. In the opposite case, when property rights are insecure, economic agents have no significant reason to operate officially, as they face the same or in some cases even greater risk at higher costs than if they operate within shadow economy. This is because official laws and institutions for the majority of individuals function nominally, whereas within large shadow economy unrecorded but socially embedded informal institutions may be even more protective or at least provide clearer "rules of game". Thus, unsecured property rights remove the main difference between official and shadow sectors for most of economic agents. Moreover, environment of unprotected property and permanent risk of loss inclines individuals to act accordingly, namely to try to get as much as possible at a shorter time and apply everything before somebody deprives it. Therefore, unsecured property rights promote not only a short-term orientation but also unfair and sometimes clearly criminal methods for income obtainment, causing deterioration of existing formal and social norms until new informal institutions form and substitute the previous ones.

It is also important to mention corruption, which is associated with large shadow economy. Corruption is one of the aspects that has significant negative effect on the entrepreneurial intention for official entry, primary

due to general distrust of individuals towards government. That is especially true if security of property rights is weak and corruption is present within juridical system. Moreover, if corruption is widespread shadow participants and, sometimes, official firms have to participate in corruption activities. That participation increases costs of operations, while as avoidance of corruption may cost even more, therefore, entrepreneurship is characterized by lower output of operations than it would be otherwise.

There is one another important issue to regard in the context of shadow economy and entrepreneurship. Competition constituted by competitors participating in the informal sector and thus gaining unfair advantage over official firms also pushes creative individuals into either unproductive entrepreneurship or to the informal economy. Perception of unfair competition also decreases perceived desirability and feasibility of a business establishment thus restraining entrepreneurial entry decision.

However, besides theory based logical estimation of shadow economy's effects on entrepreneurship it is important to investigate in particular the individuals' perceptions formed under shadow economy's conditions towards business opportunities.

4.1 Case Study: Russia

This section regards specific features of shadow economy in Russia and observes entrepreneurial environment of a case country.

4.1.1 Shadow Economy in Transition Countries: Russia

Besides general characteristics of shadow economy, researchers find differences between shadow economies in OECD, LDC and transition countries (Eilat&Zinnes 2002, 1236). The main focus of this chapter is to observe peculiarities of shadow economy in transition countries, particularly in Russia.

In LDC and transition countries causes of shadow economy are different from those in OECD countries. In OECD countries existence of shadow economy is usually connected to high taxation and burdensome labor regulations. At the same time, main causes for unofficial activity in LDC and transition countries are avoidance of taxes and regulations, corruption and general distrust to the government and political system. Moreover, for transition countries there are additional unique features. They are the process of transition to market from command economy, communist heritage, significant structural changes in a short time and privatization process. (Eilat&Zinnes 2002, 1236.)

The process of transition itself has several problems. First of them is establishment of property rights. Secured property rights require definition of private property, specific laws and institutions that supervise law enforcement, such as court system and lawyers trained in property and contract laws. In command economies, none of these prerequisites was existing and that increased complexity of the task and risk of failure of policy inefficiency. Another problem was development of banking system. As banks in socialist countries were owned by the state, they were not participating in activities that are widely spread in market economies. Thus, banks faced no competition between each other, had undeveloped credit system and had no experience in decision-making process, determining where to advance the money in order to receive profit. One more problem was inflationary pressures. The prices were not state-determined anymore, whereas the massive shortage of consumer goods, common for the economies with price control, still existed. Moreover, the shortage of goods even increased due to bankrupts of the state enterprises, which were not able to generate revenues that would cover their business costs. The last problem was communist ideology that embedded distrust of the population to the market economy. (Rittenberg&Tregarthen 2012, 1425-1427.)

Communist heritage is another crucial aspect of shadow economy in transition countries. Communist heritage in Russia includes unchanged ruling social group, corruption and shadow economy. The societal layer

governing the USSR (Communist nomenclature) has formed 77 percent of leadership of a new government and 41 percent of the new business elite. The rest 59 percent of business people were recognized to be the family members or people acting in the interests of the previously mentioned oligarchical group. Thus, public authority is a means for the satisfaction of the governing group's financial and social ambitions, the same as it was in the USSR. The logical consequence of the power abuse is widespread corruption, which transferred along with the ruling group to the new state. (Nisnevich 2015, 23.) Transfer of shadow economy is also partially connected to the earlier mentioned aspects. Due to the scarcity of consumer goods and corruption, unofficial economy was flourishing in the USSR (Grossman 1977, 27-28). As "the rules of game" have not changed significantly after the switch to the market economy, the incentive to operate in shadow also remained unchanged.

One more issue characterizing transition period is the dramatic structural change of industries and government in a short time. The price for the speed is usually the quality, thus, Russian unprepared transition from command to the market economy was accompanied with inconsistent institutional reforms. Inconsistency of reforms led to their efficiency losses. The result was in the undeveloped and poorly enforced laws and regulations, which should have been the basis for the market economy. (Rittenberg&Tregarthen 2012, 1434.)

The last aspect of transition countries that requires attention is privatization process. In Russia, privatization can be considered successful from the standpoint of its paces. However, most of the economic goals were not reached. (Supyan 2001, 144.) Even though privatization itself was an important occasion, as it helped to establish decentralized system, the problem was that reformers lost their influence. As the result, people close to the political power used the privatization for their private gains. As privatization was not effective at this point and country lack necessary institutions and regulations, privatization has brought both positive and negative effects. (Pitt-Watson & Leonard 2014.) Moreover, Zinnes, Eilat and Sachs (2002) find that ineffective privatization

is positively correlated with the size of shadow economy (Eilat and Zinnes 2002, 1245), what is a case of Russia.

Eilat and Zinnes (2002, 1236) state that earlier described features affect all aspects of unofficial economy. Thus, Kaufmann and Kaliberda (1996, 2-4) describe several characteristics of shadow economy in transition countries. The first peculiarity is that state officials and enterprise managers actively participate in unofficial activities in order to gain flexibility to the operations and generate flows of personal income from state assets. The second characteristic is that unofficial activities are large and visible except for the accounting needs. The third attribute is that shadow activities are usually nonviolent and noncriminal. Another feature is that economic agents usually participate in both official and unofficial activities simultaneously or vary them, thus there is no strict division between official and unofficial activities. This is especially true for the countries of the former Soviet Union. One more peculiarity inherent to the shadow economies in countries of the former Soviet Union is that economic agents have access to the social services and state subsidies even operating unofficially. The last characteristic is that shadow economies in transition countries are responsive to the economic incentives from the state policies. (Kaufmann & Kaliberda 1996, 2-4.) The researchers also found that in transition countries that had experienced drastic drop in the official GDP, shadow economy acted like safety net mitigating this drop (Kaufmann & Kaliberda 1996, 21).

Increase in unofficial economy is claimed to be unavoidable for the transition countries, since they are going through significant systematic change (Eilat & Zinnes 2002, 1246).

Transition countries are characterized by more incentive regulations. This consequently leads to the larger corruption, especially bribery, greater tax burden on official activities and large discretion of regulatory framework. Whereas all these attributes are associated with larger shadow activities. (Schneider & Enste 2000, 86.) FIGURE 5 shows Johnson, Kaufmann and Zoido-Lobatón (1998a, A61) find the former Soviet Union countries to get

stuck in a bad equilibrium, meaning they mainly have large tax and regulatory burden and discretion, greater corruption, weak rule of law and, hence, large unofficial sector. Eilat and Zinnes (2002, 1234) suppose that such extensive regulations restrict activities that in a well-functioning market economy would be legal and even necessary.

4.1.2 Entrepreneurial Environment

Specific features of shadow economy in transition countries, especially in Post-Soviet ones (including Russia), help to understand economic processes occurring and the initial reasons behind them. Although named characteristics describe Russian economy more precisely, they are still rather general and cannot be applied to any economy in transition. Therefore, it is important to investigate economic conditions of a particular country, its entrepreneurial environment, the same as to study institutional framework shaping economic context.

TABLE contains the most significant indexes of Russian economic performance from 2011 and to 2015 provided by Russian Federal Statistical Agency – Rosstat (2016). It is visible that GDP, GDP per capita, Budget income and Budget expenditure are increasing, while unemployment is decreasing. Therefore, it might seem that economic performance has been improving. However, if to pay attention at the inflation rates and to calculate the same indexes accounting inflation, it is clear that economic growth rates are decreasing after 2012. In 2014, real economic growth was less than 1 percent, while as in 2015 economic performance loses about 3% in comparison to the previous year. GDP per capita and budget income face even greater decrease from their index score. GDP per capita that has faced rather significant growth in 2012, falls by 2,6% in 2014 and in 2015 drops even more, by 4,4%. Consolidated budget income starts to decrease in 2013 and loses 0,5% and 1% accordingly until 2015, in which the drop constitutes 7%. At the same time state's expenditure does not fall that much, while as budget deficit increases drastically. All these indexes show 2012 as economically

successful year, while as since 2013 economic performance has been declining and drops dramatically in 2015 revealing recession. One more evidence for estimating recession is changes in unemployment rate. Unemployment, which is decreasing until 2014, in 2015, grows by 10%. Decreasing unemployment that may be the sign of economic recovery, may also show decrease in number of job seekers because individuals leave labor market and start to do something else. Moreover, in context of shadow economy and recession, declining unemployment may evidence transfer of labor from formal to informal sector.

TABLE 1. General economic indexes (Rosstat 2016)

	2011	2012	2013	2014	2015
GDP (in bil. of RUB)	59698,1	66926,9	71016,7	79199,7	83232,6
Real GDP (in bil. of RUB)	59698,1	61798,3	62588,9	63038,4	61249,4
GDP per Capita (in bil. of RUB)	417584	467361	494866	533539	551919
Real GDP per capita	417584	431547,16	436138,64	424666,82	406147,05
CPI	106,1%	106,6%	106,5%	111,4%	112,9%
PPI	112,0%	105,1%	103,7%	105,9%	110,7%
GDP Price Deflator	115,92%	108,30%	104,77%	10,73%	108,16%
Unemployment (in thousands)	4922	4131	4137	3889	4264
Consolidated Budget Income (in bil. of RUB)	20855,4	23435,1	24442,7	26766,1	26922,0
Consolidated Budget Expenditure (in bil. of RUB)	19994,6	23174,7	25290,9	27611,7	29741,5
Budget Deficit (in bil. of	860,7	260,4	-848,2	-845,6	-2819,5

RUB)					
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Although downturn in economic performance is clearly visible, it is worth investigating its consequences for the private sector and entrepreneurship in particular.

Private ownership dominates over other types of company's ownerships in Russian economy. Private sector includes four main segments, determined by the company's size. They are large businesses and SMEs, which include micro-, small- and medium-sized enterprises. Large companies are accounted to about 49 percent of all private companies in 2013-2014, while as SMEs represent the rest half of private sector. That is illustrated in FIGURE 6. Micro-enterprises, which can employ up to 15 people and have annual turnover to 60 million rubles take about 45 percent of the market share. Small enterprises, which employ from 16 to 100 people and have annual turnover up to 400 million rubles, represent only about 5,7 percent of all private companies, while as medium-sized companies, employing from 100 to 250 people with annual turnover to one billion rubles, constitute less than one percent.

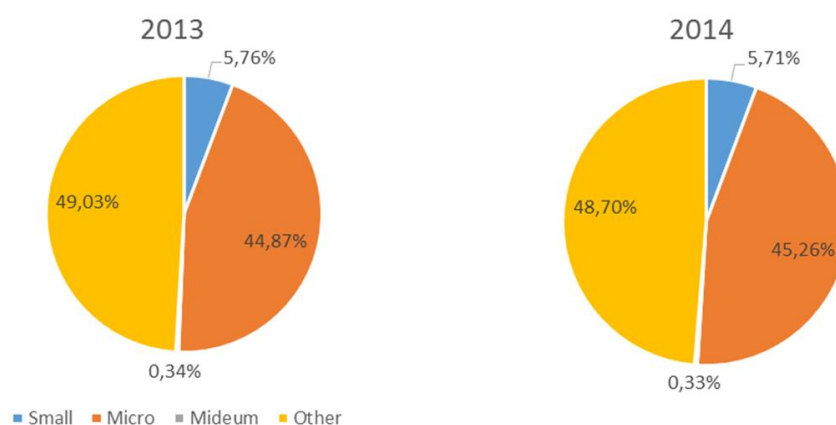


FIGURE 6. Share of SMEs in total number of private enterprises (Rosstat 2015)

Further investigation of the private sector and SMEs regards the Federal statistical agency Rosstat provides data from 2011 till 2014, where total number of micro - , small- and medium- sized enterprises has increased. Besides the increase in total number of enterprises, number of small and medium-sized businesses have decreased. Only the number of microenterprises was growing constantly during 4 years. However, that may be explained not only by new entries but also by reduction in activities of small and medium companies. From this standpoint, there are two reasons for the transformation from small and medium-sized business back into microenterprise. The first one is unfavorable economic situation driven by the lack of demand on the market. The second explanation is a transfer of some business activities into the shadow, thus avoiding the official recording and taxes. However, combination of both options is also highly possible due to present recession and widespread informal sector, which may act like a safety net.

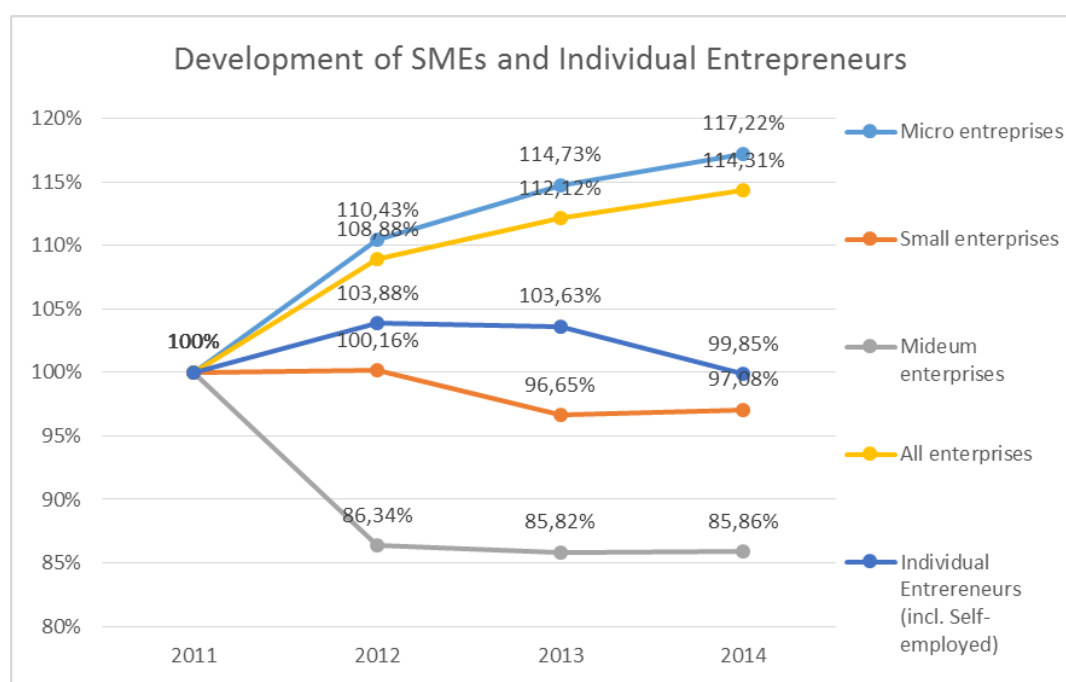


FIGURE 7. Development of SMEs and Individual entrepreneurs (Rosstat 2016)

It is visible on FIGURE 8 that annual turnover of small and micro enterprises increases, while as turnover of medium-sized companies declines. However, if to extract inflation (PPI) effect, turnover of small enterprises has decreased from the base year 2011 by 8% in 2012 and has stuck at this level for the following years. Turnover of medium enterprises (represented in fixed value of money) has faced decrease in 2012 by 13% and by 3,4% more in 2013, although decline has stopped in 2014. Turnover of microenterprises has boomed in 2012 by 13% over its level in 2011 and in 2013, it has increased again by 5% comparing to the previous year.

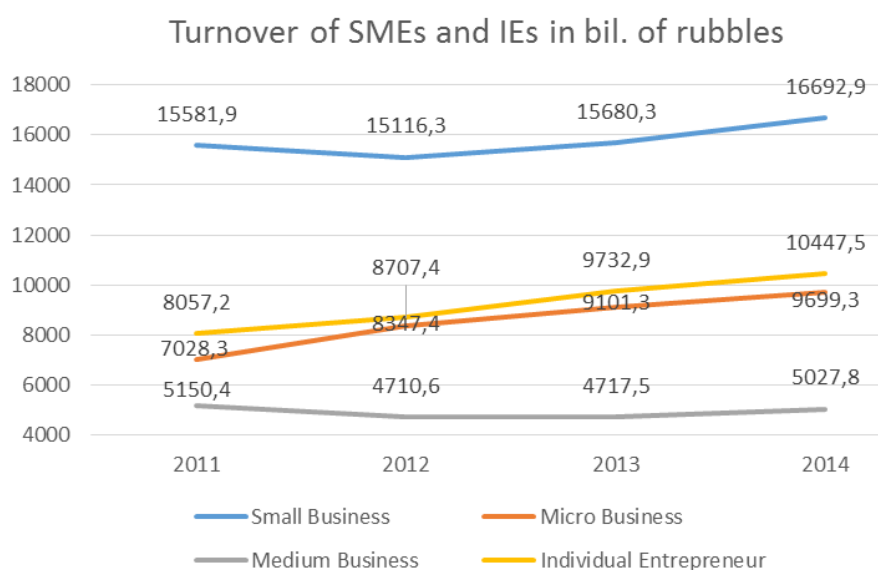


FIGURE 8. Changes in Turnover of SMEs and IEs (Rosstat 2016).

Significant drop in the turnover in 2012 might be explained by the consequences of a financial crisis in 2011. The following year is the year of started recovery, when some enterprises have left the market and new

ones have not appeared yet; some have decreased operations in order to survive and at this time just begin to increase capacities; some enterprises have left partially or entirely to the informal sector and have not returned into official economy still. Moreover, taking into account lower purchasing power of the population, hence, demand and increased inflation, decline in volumes of produced and traded goods is not surprising. However, time lag and considerable economic success of 2012 based mainly on positive expectations have left little opportunity for a quick economic recovery.

Accession to the WTO in times of economic vulnerability and depressed domestic production sector has provoked next wave of economic recession in the following years. In 2014 economic situation becomes even worse due to exacerbation of political relationships on international arena, accession of Crimean peninsula, imposition of economic sanctions and drastic decrease of oil prices. Recession and recent external occasions have created unfavorable environment for the development of private business. Such environment is characterized by decreasing demand and substantial problems in obtaining funds due to outflow of foreign capital, decrease in personal income and savings for own-financing, unstable floating ruble and constant inflation. Moreover, barriers for international trade due to sanction (import and export) have left some sectors undeveloped with weak competition and some sectors with great surplus of goods produced. These environmental problems have consequently caused standard reaction of economic agents. In such conditions companies either leave the market or reduce operations, hence business grows smaller. Furthermore, new entries are common only for microenterprises due to financing difficulties. Because of the same reason micro- and small-sized enterprises have challenges to grow.

Development of economic sectors and extent of entrepreneurial participation in them may also provide ideas about economic environment and entrepreneurial behavior within it. Figure# represents the average distribution of micro-, small and medium businesses by economic sectors from 2011 to 2014. The results of the data investigation provided by Rosstat shows that small and medium businesses find non-productive,

service sectors the most attractive. Only about ten percent of enterprises is engaged in production versus 40 percent of trade organizations. Moreover, twice the difference between production sector and renting sector shows that entrepreneurs perceive real estate activities more profitable than production. That allows supposing that production sector involves not only greater costs but also other issues, hindering attractiveness of the sector, which may include institutional ineffectiveness, financial inability, informal economy and corruption. Little number of small and medium- sized businesses in agriculture is the first sign of ineffective resource allocation, as developed agricultural sector is one of the determinants of economic growth. While as in Russia, agriculture is one of the least attractive activities for the entrepreneurs. Even less developed sectors are natural and energy resources. Small number of firms participating in these sectors reflects presence of excessive entry barriers and probability of monopolized competitive environment. Distribution of the businesses over the sectors is uneven that cannot enable stable economic growth, especially due to concentration on non-productive activities. Inefficient resource allocation also allows assuming low level of innovativeness of Russian entrepreneurship that does not have to endure high pressure of competition within some of the sectors. Moreover, low allocative efficiency and poor innovativeness due to delayed development of core sectors hinders entire economic growth.

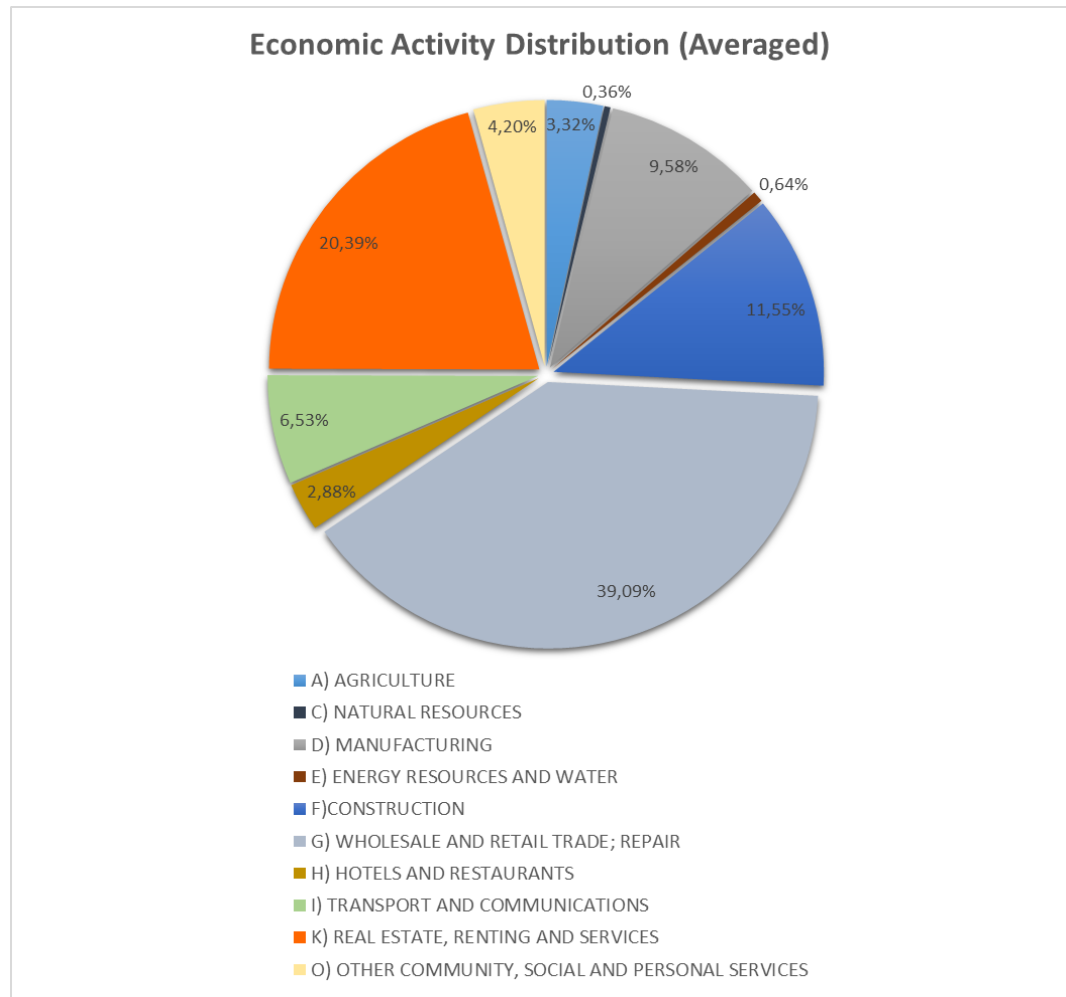


FIGURE 9. Distribution of firms by economic sectors (Rosstat 2015)

If to observe recent development of economic sectors, it is worth mentioning that most of them have been facing growth over the years 2011-2014. The highest growth was in Transport and Communication, Construction and Natural Resource sectors respectively. The only reduction of activities has happened in agricultural sector, particularly in 2014, as in years 2012 and 2013 it faced slight growth. As the activity in 2011 is taken for the base year for the calculations of yearly growth, FIGURE 10 reflects stability of growth over the years 2011-2014. Year 2012 was economically successful, as almost every sector has developed

by more than five percent, whereas years 2013 and 2014 were less prosperous.

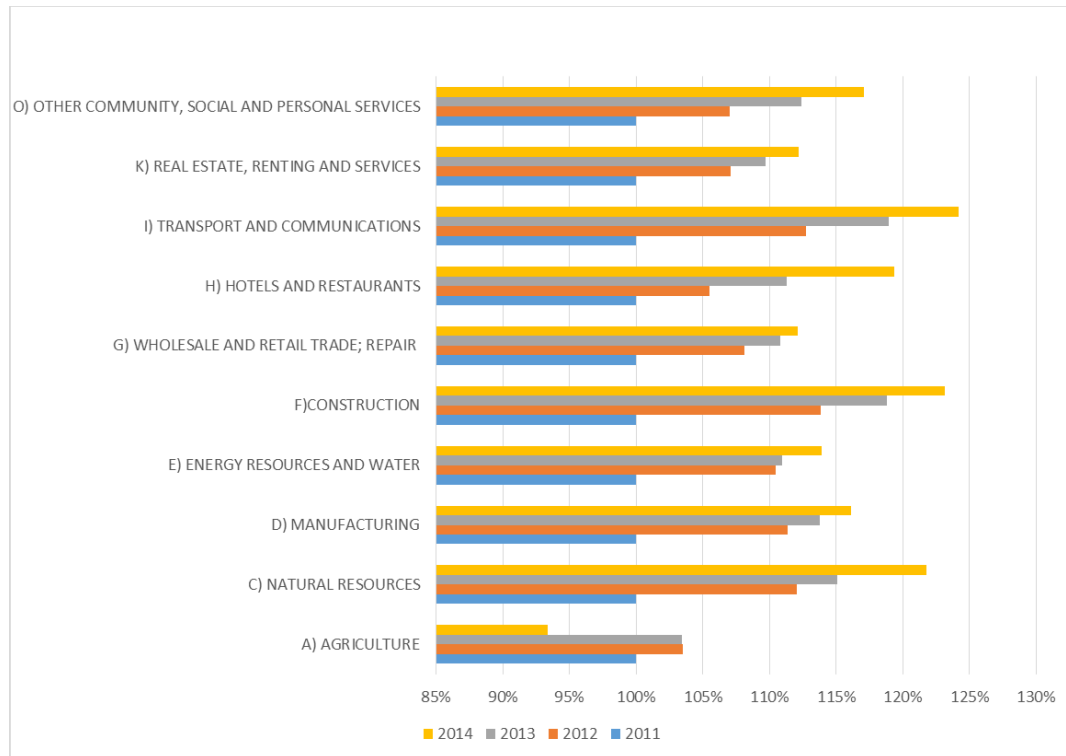


FIGURE 10. Participation rate of SMEs in economic sectors over years 2011-2014 (Rosstat 2015)

However, as number of enterprises in each sector differs significantly, number of entries in real estate differs accordingly from the number of entries in energetic sector. Thus, even though number of enterprises in less developed sectors grew, the overall perception of the sectoral attractiveness for entrepreneurs has changed little. Despite the distribution of enterprises over the sectors, stable growth of the sectors is a positive sign. It is possible to suppose that entrepreneurs have found good opportunities in transportation and communications sector, hotel and

restaurants business and natural resources. Construction sector has remained one of the most attractive ones, the same as trade, as it grew by more than 10 percent, while as being the largest sector of small and medium sized business.

One more issue for investigation of entrepreneurial environment is development of individual entrepreneurs. Term “individual entrepreneur” refers to the registered individual with the right to engage in entrepreneurial (commercial) activities without the formation of a legal entity. FIGURE 7 above shows that number of individual entrepreneurs increased in 2012, however in 2013 it has faced slight decline followed by dramatic decrease in 2014. Besides decrease in number of individual entrepreneurs, their consolidated turnover for the same years expressed in both real and fixed value of money has increased significantly. Changes in turnover excluding inflation effect (PPI) amounted to 12,34% in 2014 compared to the level of 2011 with the highest growth by 7,79% in 2013 over the previous year. Such results may be obtained due to smaller rate of inflation on the producer goods in 2013 and positive expectations with new opportunities formed in 2012 that have motivated individuals to start operations as entrepreneurs. Slight decrease in number of individual entrepreneurs with the increase in turnover in 2013 allows supposing that weaker players have left the market, while as the remaining ones have strengthened their positions in the market. The same situation occurs in 2014, although decline in number is higher and growth of turnover is smaller due to rougher economic conditions.

Sectoral distribution of individual entrepreneurs in many respects is similar to the SMEs’ one, although there are several significant differences. Sectorial affiliation of individual entrepreneurs is represented by the FIGURE 11. According to the FIGURE 11 trade is the most attractive sector for individual entrepreneurs, the same as it was for SMEs and its share exceeds 50%. Transport and communications is revealed the second most popular sector for individual entrepreneurs and it involves about 12% of them. Real estate operations, renting and services have attracted about 11% of individual entrepreneurs and is the third largest

sectors. Number of participants among individual entrepreneurs in agricultural sector is 5,67%, which exceeds share of SMEs engaged in the sector, however still comparably small. Engagement in manufacturing activities is extremely small among individual entrepreneurs, just 4,46% making it one of the most unattractive sector. Such low figure may be the result of the higher initial capital required for the production processes. For the same reason participation of individual entrepreneurs in construction sector is even smaller (2,85%). Natural resources (0,01%) and energy and water resources(0,04%) sectors engage the lowest number of individual entrepreneurs, the same as SMEs. That fact reflects existing participants of these sectors are not interested to draw smaller entities and individual specialists, hence, corresponds to monopolistic tendencies.

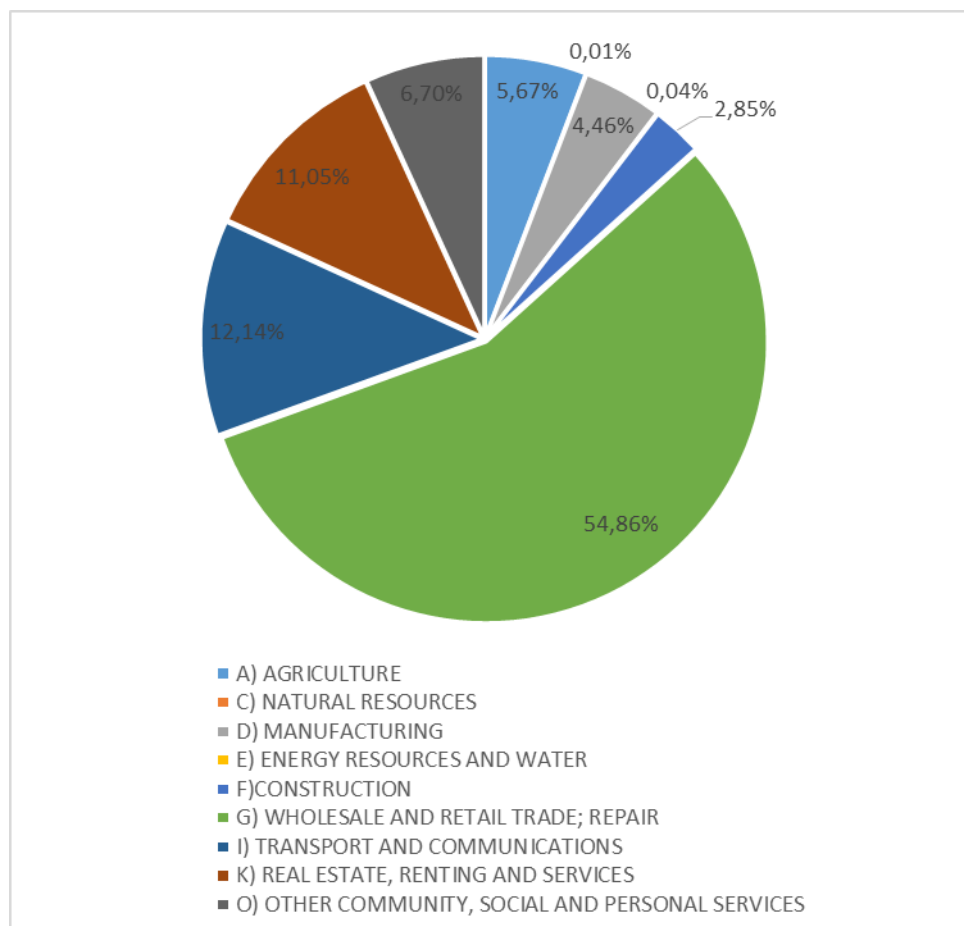


FIGURE 11. Distribution of IEs by economic sector (Rosstat 2015)

Summarizing acquired information about SMEs and individual entrepreneurs it is possible to make several assumptions about entrepreneurial environment in Russia. Firstly, most of entrepreneurs prefer non-productive activities like trade, real estate operations and service provision. However, construction sector is found attractive, while as sector of transportation and communications has gained popularity and growth during the mentioned years. Agriculture and particularly farming is more attractive for individual entrepreneurs than for small- and medium-sized enterprises, however entries in both of cases are very rare and entrepreneurial participation rate is low. The situation in manufacturing is little better - the sector is obviously depressed, hence, characterized by low paces of development and engagement rates. That reveals presence of substantial barriers preventing new entries. One of them is acute shortage of financial sources, hence, difficulty to obtain funds, as other sectors that require significant investments are also unpopular. Another possible barrier is monopolistic environment of some high-yielding sectors, which in combination with unavailability of capital makes these sectors inaccessible for the private entrepreneurship.

Secondly, such sectoral preference and size-distribution of companies corresponds to the characteristic situation for market described by Eilat&Zinnes (2002,1244-1246), where large shadow economy is present. Researchers mention that for large shadow economies in transition is typical very small number of medium-sized enterprises, while as small and large ones are prevailing. Furthermore, resources are gravitated to the sectors amenable for shadow economy like construction, trade and services, whereas agriculture is attractive for large businesses; production based on economies of scale is depressed and monopolistic intentions are present in the economy.

Thirdly, paces of entrepreneurial development during observed years are rather slow and unstable. As an example, Global Entrepreneurship Monitor (GEM) cites the data for the year 2014 that helps to continue consideration of the entrepreneurial potential within Russian economy. Global Entrepreneurship Monitor provides key indicators of entrepreneurial activity. Based on the data of 2014 it states that about 90 percent of population in Russia is not involved in business activities. Moreover, this number represents also those, who is not interested in setting up a business venture. GEM's TEA index represents percentage of the population between 18 and 64 years old, who are owner-manager of a new business or nascent entrepreneurs (plan to enter in 3 years). In Russia TEA's score is lower than five percent of the population. Individuals who are now owner-managers of the established enterprises, which pay salaries for more than 42 months, make up just about four percent of the population. People who find desirable to start a new business within three years compose 3 and a half percent of the population. Perceived opportunities index recognizes 27 percent of people, who see good opportunities to set up a new enterprise. Whereas perceived capabilities index shows that 28 percent of the population believe that they are skilled enough to start a new firm. Fear of failure index has the greatest score of 42 percent of the population representing the amount of people who will not start their business due to the high risk of failure. All the data is summarized in the Table 2 below.

TABLE 2. GEM's key indicators of entrepreneurial activity in Russia 2014 (Global Entrepreneurship Monitor 2014)

TEA	4,7%
Established Business Ownership	3,9%
Perceived Opportunities	27%

Perceived Capabilities	28%
Entrepreneurial Intention	3,5%
Fear of Failure	42%

GEM states public policies are the main constraint for the development of the entrepreneurship in Russia. However, one more factor negatively affecting entrepreneurial development may be wrong perception of opportunities by potential entrepreneurs. Only about 18 percent of non-entrepreneurs believe that economic environment is favorable to set up the business, while as among active entrepreneurs the figure is twice higher. (Global Entrepreneurship Monitor 2014.)

As state's policies are one of the significant external factors affecting entrepreneurial intention, investigation of institutional framework in Russia is useful, while observing entrepreneurial environment. For the base of investigation in this study is taken the Index of Economic Freedom provided by the Heritage Foundation, which represents institutional framework and its favorability for the entrepreneurship in Russia.

Russia is rated by 153 place in the Countries' Ranking list, as a country with mostly unfree economy. The Figure 12 shows the changes in Russian score from 2011 to 2016. The highest score 52,1 was achieved in 2015, however variability of index score remains within the period from 50 to 53 points. The Heritage Foundation provides the division for the measurement ratings:

- > 50,0 – Repressed economy;
- [50; 60) – Mostly unfree economy;
- [60; 70) – Moderately free economy;
- [70; 80) – Mostly free economy;
- < 80,0 – Free economy.

Based on the Index of Economic Freedom score it is possible to state that Russia is on the edge of mostly unfree economy closer to the repressed one, namely the country is characterized by excessive regulations, what corresponds to the features of shadow economy in transition countries provided by the economists and described earlier.

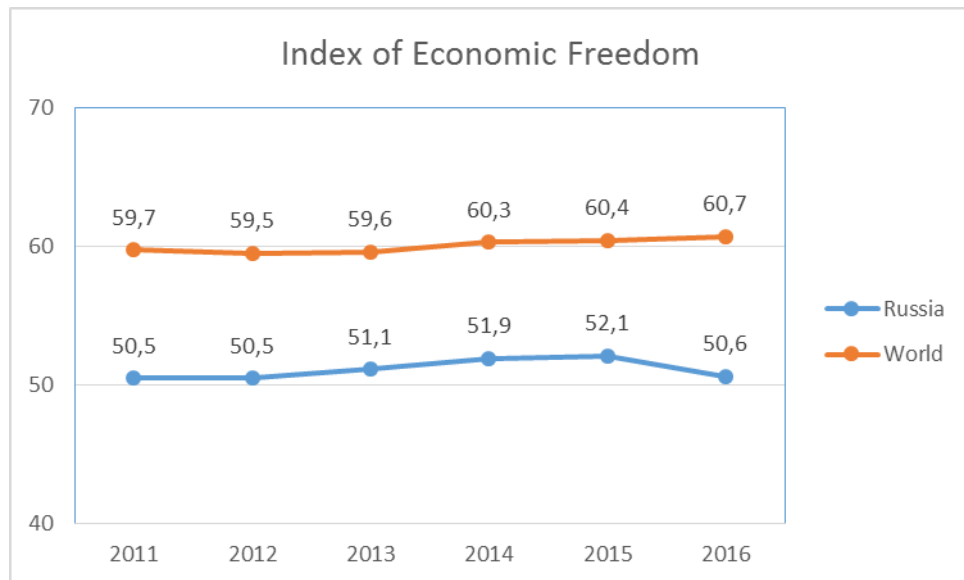


FIGURE 12. Changes of Economic Freedom Index over years 2011-2016 for Russia and World's Average (The Heritage Foundation 2016)

Index of Economic Freedom is accounted based on number of dimensions. Scores of these dimensions in comparison to the world's average scores may provide insights of what inhibits entrepreneurship in Russia.

TABLE 3. Measurements of Economic Freedom (The Heritage Foundation 2016)

Measurements of Economic Freedom (%)			
		Russia	World
Rule of law	Property Rights	20,0	42,0
	Freedom from Corruption	27,0	42,6
Limited Government	Government Spending	56,2	65,7
	Fiscal Freedom	82,2	77,8
Regulatory Efficiency	Business Freedom	72,2	64,1
	Labor Freedom	57,6	59,7
	Monetary Freedom	62,9	75,7
Open markets	Trade Freedom	72,4	76,1
	Investment Freedom	25,0	58,0
	Financial Freedom	30,0	48,8

Thus, the greatest problems in Russia are unsecure property rights, corruption, strict investment policy and inefficient financial sector. Most of the issues are connected to the size of the government and its control over juridical and financial institutions, which in the result lack independency. The consequences are general distrust towards political and juridical systems and inaccessibility or unattractiveness of capital markets. However, scores of Fiscal, Business and Trade freedom are surprisingly

high. The first two exceed the world's average, which indicates flexible taxation system and easiness of business entry and exit.

Significant problems with safety of property rights and corruption leave entrepreneurs officially unprotected and increase risk of doing business, hence, significantly decrease perception of safety and trust towards official institutions. In such conditions, other highly rated aspects of economic freedom are less likely to attract massive official new entries. Moreover, legal insecurity leave space for large shadow economy with its informal institutions, which may seem more or the same attractive for the newcomers as the official sector. Things getting worse with the unavailable funding in official sector, which could restrain growth of informal economy otherwise. Another negative consequence of hardly accessible finance is slower development paces of entrepreneurship that have to rely on own-financing and, hence, slower economic growth.

Although problems within institutional framework may hinder business activity or promote its transfer to unofficial sector, the entry and the transfer to the shadow themselves are the result of the decision of economic actors, which in its turn occurs out of individuals' perceptions. Hence, originally higher perceptions or unawareness of individuals may mitigate a little negative effects of institutional problems. Therefore, the core issue for investigation is perceptions of the population within Russian economic environment.

5 DESIGN OF EMPIRICAL RESEARCH AND DATA COLLECTION

Formulation of the research question and sub-questions showed the deductive approach is the most beneficial. Theoretical part answers the first and the second sub-questions (“What is shadow economy?” and “How shadow economy is related to the entrepreneurship in Russia?”). The third sub-question (“How shadow economy influences willingness to start a new business and mindset of active and potential entrepreneurs in Russia?”) and fourth sub-question (“What are the prospects for development of entrepreneurship in Russia in the next few years?”) are addressed to the empirical part of the study.

Research on the existing theory has revealed the apparent connection between shadow economy, entrepreneurship and institutional framework, which is circulative in nature. Government policy of Economic Freedom is considered an ideal policy for efficient market economy with no or very small shadow economy and prospering entrepreneurship. Complete Economic Freedom is hardly attainable, however it serves as an absolute to measure how far a particular economy is from the ideal, namely, how free that economy is. One of the most popular measurements is the Index of Economic Freedom provided by The Heritage Foundation, which includes aspects related to both shadow economy and entrepreneurship. Therefore, Economic Freedom and its constituents form a perfect framework for investigating interrelations between shadow economy and entrepreneurship.

Theory investigation has also showed influence of psychological and social factors on decision-making process and on following actions of economic agents, i.e. individual perceptions and attitudes ensuring certain reaction on a specific event. Thus, expanded entrepreneurial process model consists of not solely active/action phase but also includes silent phase that enables any further actions.

Research question and sub-questions addressed to the empirical part require concentrating on the first two steps of entrepreneurial process that

constitute silent phase. These are recognition and attitude towards opportunity and formation of entrepreneurial intention. Thus, empirical investigation is aimed to learn the attitudes towards business opportunities and perceived desirability and feasibility of entrepreneurial entry, which have developed within environment of shadow economy. One more objective of the empirical investigation is to study differences in perceptions of potential (non-entrepreneurs) and active entrepreneurs towards socio-economic (environmental) factors in order to identify perceived barriers.

In order to provide complete answers to the research questions mixed-methods research approach is chosen. As it was described earlier in the Introduction chapter, there are two main research methods: qualitative and quantitative (Saunders, Lewis & Thornhill 2009, 151). This study utilizes both research methods, which follow one another. Therefore, empirical part of this thesis involves two stages. The first stage is gathering qualitative data through semi-structured interviews and their analysis. The second stage is gathering quantitative data applying the survey strategy and analysis of obtained data.

The author of the thesis asserts presence of large shadow economy in Russia and bases on this assertion the following analysis procedures. Although respondents do not necessarily have to assume or to be aware of the effects of present shadow economy, as their personal judgments are the issue for investigation.

Data collection framework includes list of topics, developed from the aspects of Economic Freedom Index and their suggested values referred to the shadow economy. Thus, "Security of Property Rights" aspect is divided into security of property rights, efficiency of juridical system and contract enforcement. "Government Spending" aspect is evaluated through efficiency of public services and institutions and through social security system and social transfers. Financial and Investment Freedoms are investigated through availability of funding and short- or long-term orientation of the economic agents. Fiscal freedom is represented by the

tax burden, Labor Freedom by the Employment norms and Trade freedom by the market regulations. Business Freedom is studied through the costs of entry and exit, Monetary Freedom through the price controls, which are the part of the market regulations and the last aspect of Economic Freedom investigated is Corruption. Competition is the final topic included due to the effects of shadow economy on its nature and direct connection to the entrepreneurship.

As was mentioned earlier, data collection was carried focusing on the aspects of Economic Freedom, however did not ignore the influence of the other factors and assumes their effects in the analysis procedure.

5.1 Data Collection: Semi-structured Interviews

In order to investigate questions addressed to the empirical part the semi-structured interviews are utilized first due to several reasons. Firstly, it is hard to build appropriate questionnaire for the experienced persons and get reliable data due to high risk of flaws. Secondly, it is complicated to obtain large number of responses from the entrepreneurs necessary for the assessment of questionnaire, whereas more detailed interview may compensate that through explanation of the reasons behind the response. Thirdly, active entrepreneurs, while speaking freely, may provide clues and ideas during the interview necessary for the research, thus helping to get reliable data. However, during the interviews earlier determined list of issues have to be covered. Therefore, utilization of the semi-structured interviews was the best option.

In total two interviews were set up. In the first one, the respondent was the entrepreneur, who temporarily quitted the market. However, he owned and managed two consulting companies (one after another) in total within five-year period until the last year (Interviewee 1). In the second interview, the respondents were a family couple, who share and run limited liability wholesale company. However, the main interviewee was a man, while as woman provided several comments. Therefore, the family couple are calculated as one person in the analysis (Interviewee 2). The respondents

belong to the different age groups (27; 51, 35 years respectively). They also differ in amount of work experience and in length of entrepreneurial activity.

During the interviews earlier mentioned list of aspects was embraced, however, the respondents were free to speak about what they believed was worth mentioning. Both of the interviews were held on the same day and were recorded on Dictaphone for the further assessment.

5.2 Data Collection: Survey

The second stage of the empirical research is an electronic questionnaire. The survey includes 18 questions based on the same “list of issues” and on the insights received during the interviews.

Different types of questions were designed. They involved single and multiple choice list questions, category questions, rating question and matrix question. However, no open-ended questions were included. Variables for the questions were opinions, behavior and attributes. To ensure that all the essential data would be collected to answer the research questions, the researcher created data requirements table (Saunders, Lewis & Thornhill 2009, 368).

Targeted group for the questionnaire was the people between 18 and 64, the same as utilized by the Global Entrepreneurship Monitor. However, upper limit was not as strict as the lower one. Whereas answers of individuals under 18 were not accounted in the analysis, answers of older individuals were not excluded.

The questionnaire was distributed through the social nets, which are widely used today, although rarely by the people above 65. This completely suits target group requirements. Survey was available for the respondents for the five days. After this time period total number of responds was 141, including two of under-aged persons, which were excluded from the analysis. Thus, the final number of responses acceptable for the assessment was 139.

6 ANALYSIS OF THE INTERVIEWS

Semi-structured interviews included list of topics to be covered in order to understand perceptions of the business activities and economic environment in relation to the shadow economy from active entrepreneurs. The topics involved were short vs long-term orientation of economic agents, tax burden, market regulations, efficiency of public services and institutions, social security system and social transfers, security of property rights, contract enforcement, competition, employment, investments and corruption. Analysis of the interviews was based on the responses upon the mentioned issues gathered from the interviewees.

One of the main topics discussed was tax system and tax burden. The common idea in both of the interviews was that informal tax avoidance and tax evasion are daily practices in Russian business. All organizations try to reduce the tax burden in order to survive. At this point opinions of the respondents has divided. Whereas owners of trade organization note that the only possibility to reduce tax burden was a transfer of some activities into underground, i.e. illegal tax evasion, the owner of consulting business found opportunities for the legal optimization of the tax burden due to complexity of the tax system. However, during the conversation it was found that the latter interviewee had also participated in unofficial activities in order to reduce taxation. Risk of being caught and punished was not a barrier for the tax evasion in both of interviews. One interesting idea was announced related to the tax systems and observance of taxes payable. The point was that small businesses were easier to hide their activities due to some inefficiency of tax institutions, which did not toughly control the tax payment processes of the small organizations. However, entrepreneurs in the trade sector were less positive about controls over the tax payments. They stated that last reform of tax institutions made tax avoidance more challenging, however it would not promote payments but organizations would still find a possibility to evade taxation. Although the tax system in Russia is complex, there are not much loopholes for a more legal tax avoidance, especially in the production and trade sectors. That is probably the reason for the division of the perceptions; as service-offering

organizations have lower direct and indirect taxes, thus they do not perceive taxation a problem, whereas for the trade and production sectors tax burden is one of the core issues in profit maximization.

Next point that was discussed in the interviews was intensity of regulations applied to the interviewees' business. The consulting business owner did not perceive regulations as a barrier for business operations the same as he did not recognize any overregulation, considering existing rules and regulations to be liberal. Although he mentioned volatility of the existing regulatory system and set of institutional norms, which were changing continuously. Wholesale owners, controversially, pointed out that much of the excessive regulations were existing, however most of them were either inapplicable practically or pointless, inefficient in implementation or volatile. These regulations were followed on the paper but practically were not executed, as avoided through shadow activities and corruption. Thus, excessive and inefficient regulatory burden was one of the causes for the participation in unofficial activities.

Corruption was another topic, which was embedded into Russian economy and political system. All respondents defined that corruption was widespread and was an obvious occasion not only in business environment but also in a household activities. For some small organizations it was possible to avoid participation in corruption activities, however the first interviewee believed that either the organization participated in corruption but grew or avoided corruption and stopped its development at a small-sized business. However, he found corruption beneficial at some point, whereas the other respondent believed it to be one of the greatest threats for the business. The idea behind widespread corruption recognized by interviewed entrepreneurs was that there was always certain price for any activity either formal production costs, including taxes and additional costs from regulations or expenses on the corruption (bribing). Sometimes even both simultaneously. The trade business owner stated the reason for such massive corruption as a bloated state apparatus with the large amount of regulatory institutions

and committees and bureaucratic opportunism, which were particularly depressing trade, construction and production sectors.

One more topic discussed was efficiency of institutions. The second interviewee perceived institutions to be inefficient and even harmful, as their value to the private and household sector was poor, whereas their work only created new opportunities for corruption activities and increases production costs. Potentially useful regulations and services were performed poorly making them inappropriate for the practical application. Moreover, corruption, bureaucratic circumlocution and subsequent management stealing in public organizations and projects in combination with the weak institutions resulted in deterioration of the public goods quality. The consulting business owner in his turn believed that efficiency of the institutions was ambiguous, as they had being performed their main tasks, however also mentioned the disadvantages. Besides, he regarded some of the institutions rather efficient, he also expressed doubts in the quality of performance of others, the same as in quality of provided public goods.

Most of the public services in Russia are distributed on the free of charge basis such as police services, education and health services; however, all of them involve additional costs that are paid from personal funds. The trade owners noted that depending on the type of service, additional expenses might vary from insignificant to substantial amounts. At the same time, social payments were minimal and usually were not able to cover even a half from the target sum. Taking into account rather poor performance of the public services entrepreneurs are paying social safety contribution payments but do not clearly understand for what and where the money are actually going. Hence, both entrepreneurs expressed no willingness to pay to the social welfare system.

Social safety contributions and taxation on labor are believed to be the main reasons for the unofficial or partially unofficial hiring of labor, which was another important topic for the discussion with the respondents. Interviewed entrepreneurs, the same as most of the private organizations,

found more beneficial to pay double salary, which was usually splitted into either official salary and gray salary or official salary and bonus. While as official salary is taxable, the second payable part avoids taxation, thus benefiting both the employer and employee. However, there were cases, when entirely unofficial hiring was practiced. Such cases were common to the project works, as it was less time and money consuming to pay cash-in-hand than to register labor contract, especially if only the small piece of work was involved into relations.

Weak and inefficient institutions discussion involved two other particularly important determinants for the entrepreneurial development: contract enforcement and security of property rights. Contracts are gaining more importance today in Russian business; however, both interviewees stated that still business cooperation was based mainly on the informal arrangements. Interviewees provided several reasons for that situation. Firstly, in case of break of contract terms, it is possible to submit to arbitration; however, that is expensive and long-lasting process, which does not guarantee coverage of losses. For the small business it is common when losses may equal the arbitration costs, thus in such case that is not reasonable and profitable to start the process. Moreover, there is a peculiarity that usually chartered capital of the firms is insignificant (10000 RUB), thus even victory of the arbitrage process may not provide coverage of the losses. Therefore, in case of small business contracts do not fully protect the firms from the losses. Secondly, if entrepreneur do not have skills in building contracts himself, building a good contract is usually an expensive service, hence, it is suitable for the long-lasting relations or relations involving significant capital investments. Thus, contracts are used, however informal arrangements are prevailing in the interrelationships, as punishment for the break of contract terms is hardly possible for the small firms and, consequently, contract enforcement is rather poor.

Interviewed entrepreneurs perceived that property rights in Russia were insecure and there could be many methods to take away the property. Respondents provided several examples of the taking property occasions

during the last years in Russia. Moreover, the government and its senior officials were perceived as one of the main threats to the property ownership. However, interviewed entrepreneurs noted that small businesses were out of the state's interests for the take, thus they faced the threat only from the criminal structures or massive nationalization.

One more important factor for the development of the entrepreneurship is availability of the risk-capital. All respondents stated that establishment of the business was possible only through own-financing and entrepreneur's personal funds. They emphasized that obtaining investments for the establishment from capital markets and government subsidies was almost impossible. Gathering capital funds for the development of the already existing business was also challenging and expensive due to the high interest rates provided by financial institutions, the largest of which were under the state control. Due to these issues, small businesses are mainly relying on the reinvestment of the earned profit. Inability to gain side investments was mentioned by the trade organization owners as one of the reasons for the participation in unofficial activities in order to save maximum of the profit for the further development of the business. That corresponds to the statement of Kaufmann and Kaliberda (1996,) that large shadow economy is almost a survival economy. Consequently, interviewed entrepreneurs did not regard opportunity of the substantial financial inputs into the business in order to gain additional efficiency and competitive advantage in a long-term perspective, thus concentrating on the maximizing of current revenues.

Competition was the last topic discussed from the list. Towards this issue respondents showed different perceptions. The consulting business owner believed that most of the enterprises tried to get competitive advantage both through raising efficiency of operations and through widespread unofficial activities, as unofficial hiring and tax evasion. He also assumed that there was a possibility to enter and to succeed in every economic sector, if financial abilities were allowing, as until there was a desire to work, there would be the opportunities. Trade organization owners had an opposite view on the situation. They recognized monopolistic positions of

public (state owned) companies in several sectors, particularly in those connected to the energy and natural resources, which dictated price policy for the price takers, such as smaller companies in trade, construction and especially in production sectors.

While analyzing the opinions and the tempers of the discussion during two interviews it was visible, that younger entrepreneur was more positive in his judgements about business environment in Russia. He also demonstrated more trust and loyalty towards the government in comparison to the second interviewee. The trade organization owner in his turn showed total distrust and scepticism towards government and business activity in Russia, believing bloated institutions and corrupted state officials to be the main barriers for the prosperity of private sector, as the main purpose of government bureaucrats was personal enrichment instead of country's development. Although attitudes towards government, both entrepreneurs were operating formally and informally, viewing shadow activities reasonable for their businesses. However, extent of their participation in unofficial economy was different. Whereas the consulting business owner found more opportunities to reduce tax burden in part legally and regulations were usually not the barriers for the business activities, his engagement in unofficial activity was relatively lesser than engagement of the trade company. Overall, the analysis of the interviews provided some ideas for the further investigation via the survey. Firstly, the defined framework of topics for covering is reasonable for application in a survey, as there were differences in perceptions of the interviewees and there may be differences in perceptions of the active and potential entrepreneurs. Secondly, differences in attitudes of the interview respondents may be explained by the differences in their age, work experience or by economic sector of their business activity. Thirdly, more attention is needed to the issues of the competition and trust towards the government.

7 ANALYSIS OF THE SURVEY

The survey was developed according to the ideas provided by the analysis of the interviews and included 18 questions (see Appendix 2). The survey gathered 140 responses, from which only 138 were applicable for the analysis due to the age limit. The analysis procedure of the survey involves two stages. The first stage involves observation and discussion of the responses gained and based on them supposes hypotheses for the second stage of the analysis. In the second stage, Multinomial Logistic Regression is modeled and tested.

7.1 Descriptive Statistics

The first question of the survey was concerned with the age of respondent. The answers of the respondents who were less than 18 years old, were excluded from the analysis. Thus, most of the respondents were from the age group between 18 and 25 years old. The second and the third largest groups of the respondents were from the age groups between 36 and 45 years old and between 26 to 35 years old accordingly. As most of people are likely to start their entrepreneurial activity within the period from 18 years to 45 years old, this sample corresponds to the requirements of the research. Figure 13 below represents distribution of responses obtained.

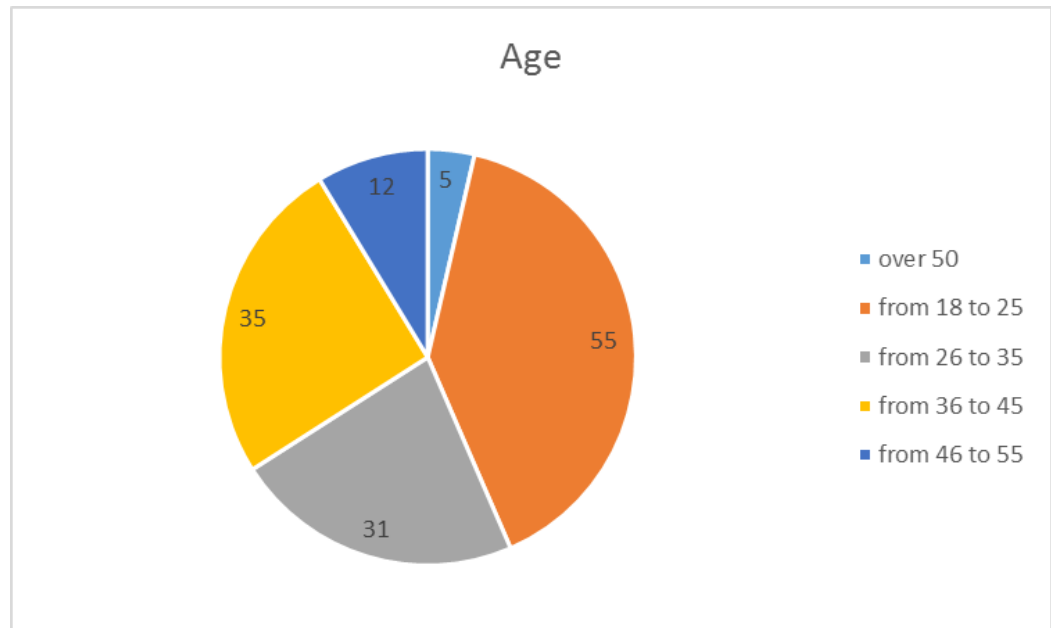


FIGURE 13. Age specification

The second question was aiming to investigate total work experience of the respondents. The idea of the question was that work experience might influence the attitudes of the respondents towards economic environment, the same as willingness to become an entrepreneur. The largest group, 48 out of 138 respondents are active economic agents for the period between three and ten years. The second largest group of respondents is working for more than 10 but less than 20 years. The smallest group represents those respondents, who have no work experience and consists from only six people. Twenty-six respondents are working for more than 20 years, while as the rest 23 respondents became economic agents lesser than three years ago. Distribution of the survey participants by work experience is represented by Figure 14.

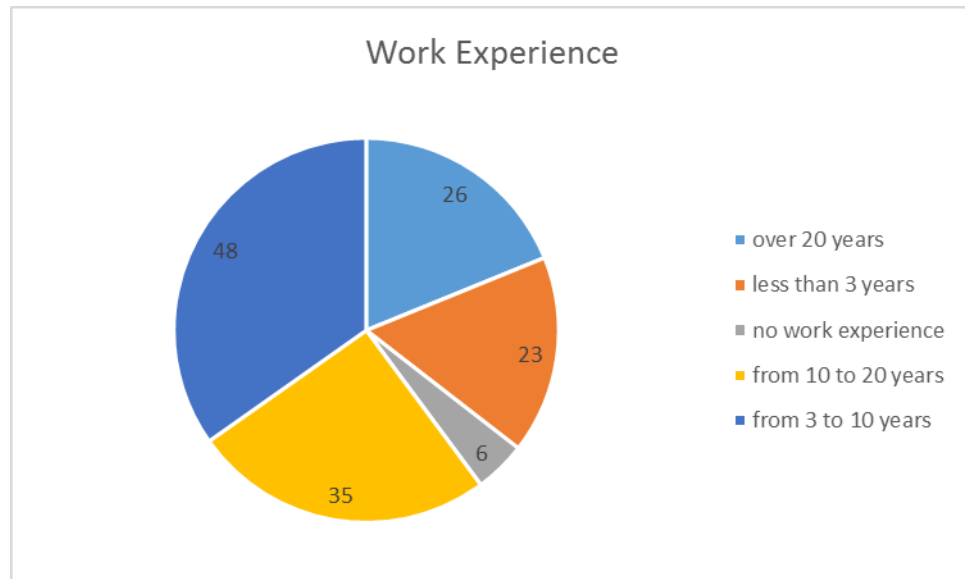


FIGURE 14. Question 2: “Specify, please, your total work experience”.

The third question investigated employment status of the respondents. The responses showed that 59 percent of survey participants are currently employed and nine percent are engaged in multiple activities simultaneously. Five percent of the respondents are self-employed and only two, namely one percent, respondents govern own business enterprise. Such results show that most of individuals prefer employment to the entrepreneurial activities. However, there is a possibility that respondents who are engaged into multiple jobs may execute some activities on a personal basis, i.e. in a self-employed manner. Seven percent of the respondents have part-time jobs, while as 14 percent of survey participants are currently unemployed. Taking into account that largest group of the respondents is from 18 to 25 years old, significant part of them may be engaged into non-economic activities, such as studies, thus explaining rather large number of unemployed individuals. There are one percent of the individuals, who have already left labor market and one percent of retired respondents, who are still working. Figure 15 represents the distribution of respondents by their employment status.

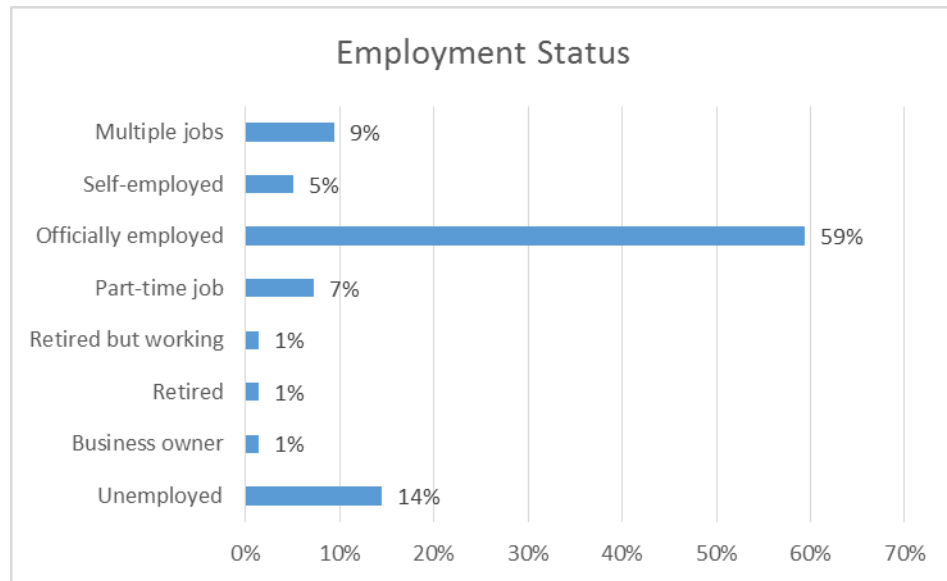


FIGURE 15. Question 3: “Please, specify your current employment status.”

The following question was investigating the main sources of income for the respondents. Official salary with the additional bonus is the most common source of income, which is followed by solid official salary. Unofficial salary is the source of income in about 14 percent of cases. Only four percent of respondents receive income from business activities and only nine percent of individuals benefit from self-employment activities. The analysis results also show that most of the respondents do not have additional income, as only six percent of respondents reported about additional income sources, which include interest payments, remunerations and various investment activities. Eight percent of respondents do not have personal income, while three percent of respondents gain income from pension payments. Analysis of main income sources may provide the insights on the tax payment habit and tax morale of the respondents.

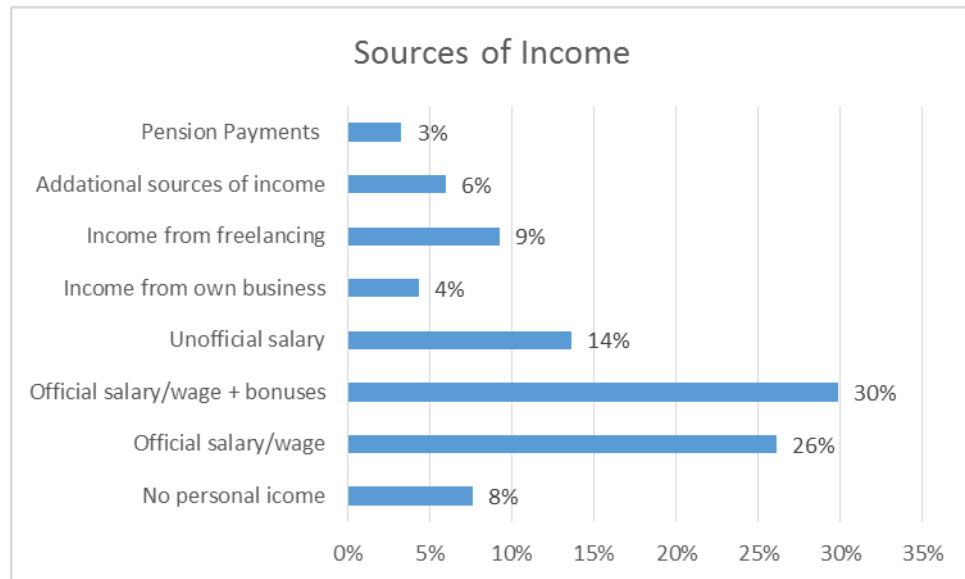


FIGURE 16. Question 4: “Choose you main sources of income”

The next two questions were studying participation of the respondents in social security system activities. Figure 17 represents amount of respondents, receiving social security payments and investigates individuals' attitudes towards these payments. Thus, about one third of the respondents receive social security payments. However, 45 percent of the respondents do not face necessity in such payments, whereas the rest 22 percent of survey participants, even though they have an opportunity for receiving security payments, find them unattractive.

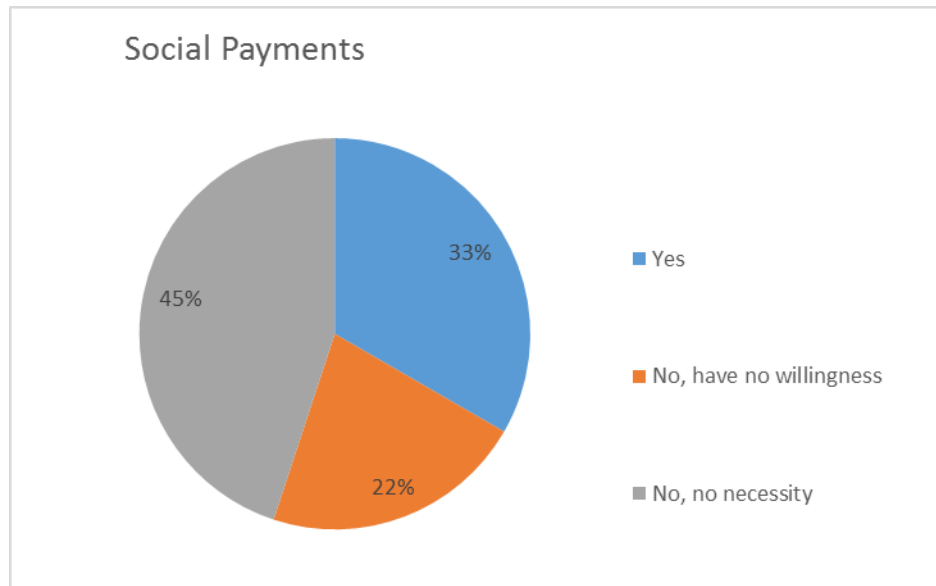


FIGURE 17. Question 5: "Have you ever received social security payments?"

The second question regarding welfare system studies exemption groups and respondents belonging to them. A quarter of all individuals answering the survey belongs to an exemption group. The most common groups enjoying privileges are students and pensioners, which are likely both represented by the respondents. Responses are illustrated in Figure 18.

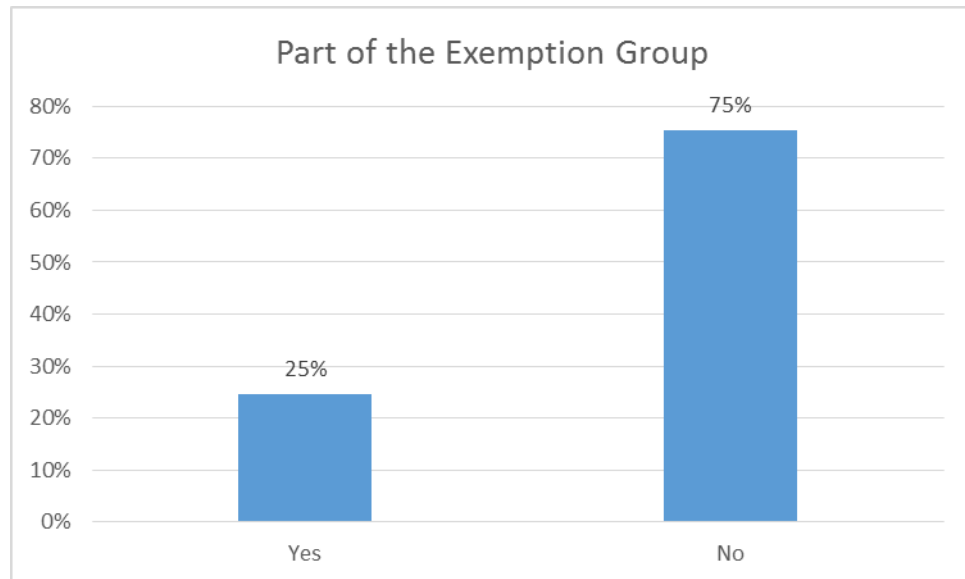


FIGURE 18. Question 6: "Do you belong to an exemption group?"

Question number 7 investigates behavior of the respondents in context of income taxation. Figure shows that most of the respondents pay income taxes only from the part of their overall income, while hiding another part. Fifteen percent of respondents do not pay income taxes, while having personal income. Six percent of survey participants are engaged in the activities that are not income generating, hence, are not taxable. Other 32 percent of the respondents report that they are paying taxes for any gained income, including bonuses, investment profits and other additional income. Based on the gained information, it is possible to assume that most of individuals are tending to hide at least a part of the income generated both through formal and informal activities. Thus, tax avoidance is rather widespread activity among individuals in Russia. Moreover, tax avoidance may become a habitual behavior of the large group of people, which may stay unchanged if they become entrepreneurs.

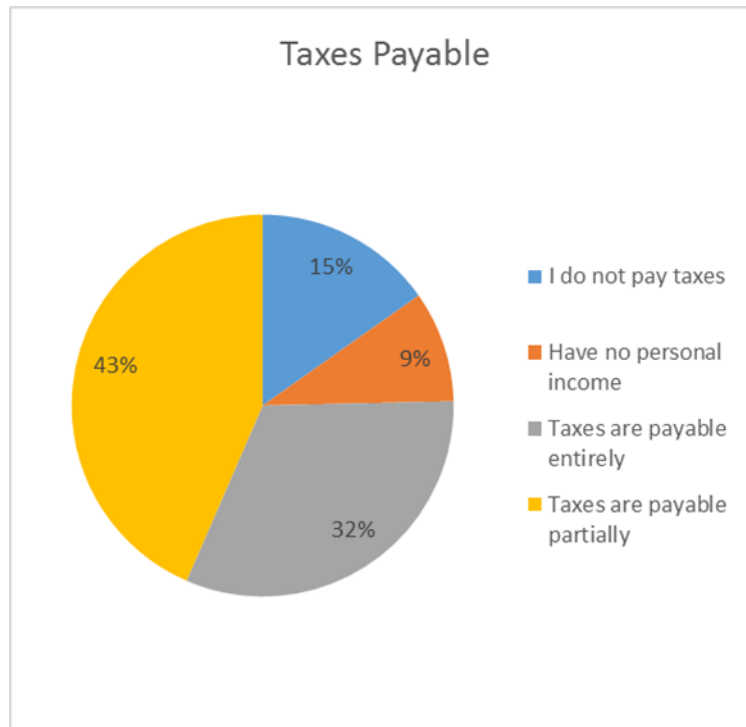


FIGURE 19. Question 7: “How do you pay your income taxes?”

The eighth question of questionnaire aimed to evaluate efficiency of public institutions and quality of provided goods and services. Almost a half of the respondents evaluated efficiency of institutions and quality of public goods and services as “might be better” admitting some inconveniences and inefficiencies in the performance. One third of the survey participants is unsatisfied with the performance of public institutions evaluating it like “poor”. Another eleven percent of the respondents perceive provided public goods and work of institutions as nothing worse. At the same time, seven percent of the respondents have positive image of the public sector, while only one percent of the survey participants believe that institutions are highly efficient and quality of public goods is excellent. The conclusion can be made that most of individuals think that institutions are mainly able to perform their tasks; however, that is not efficient performance. That allows supposing that most of the individuals perceive state not as a supportive force but more as a troublemaker.

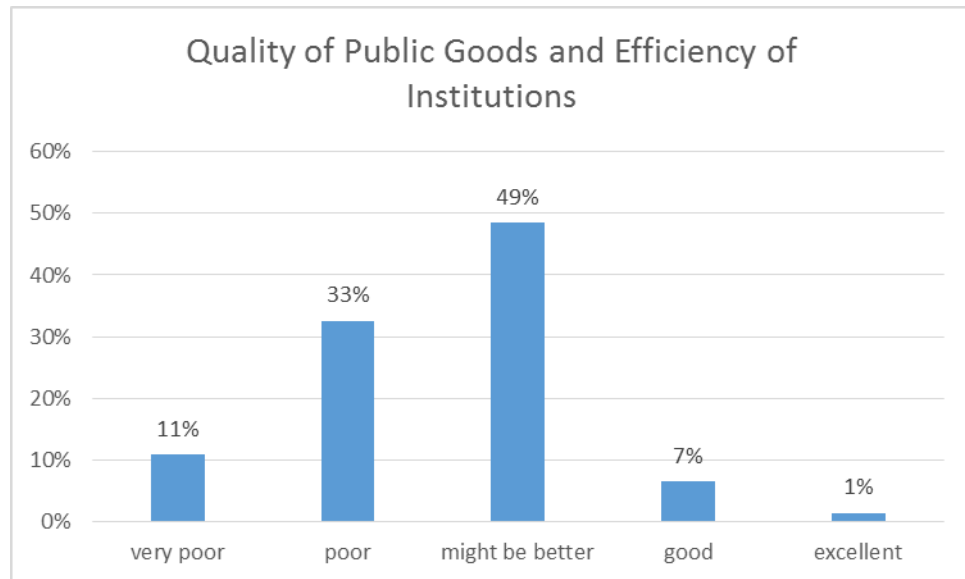


FIGURE 20. Question 8: “Evaluate, please, the quality of public goods and efficiency of the institutions.”

The ninth question investigates the willingness of the individuals to establish a new company in Russia. The results of the investigation are optimistic, as seven percent of respondents are already active entrepreneurs and about 40 percent of the respondents are willing to become entrepreneurs. Such data may evidence that entrepreneurship is currently valuable and attractive. On the opposite side, 22 percent of the respondents are not interested in entrepreneurial activity perceiving it as an activity that does not correspond to their personality. One possible explanation for such reply is that individuals from this group have set of values different from those provided by entrepreneurship. Another reason for that type of answer is lack of initiative and/or self-confidence, hindering the willingness to accept the additional responsibility that is involved into entrepreneurial activity. These people the most unlikely will ever become entrepreneurs. Another seven percent of the respondents believe entrepreneurship to be excessively risky activity for them. Hence, this group represents individuals, who cannot accept the risk of failure and the following consequences, which are present in entrepreneurship. There are

several possible reasons, why these respondents perceive the risk of failure being very high. Among these reasons are the factors of economic environment, such as institutional quality, government size, corruption, excessive of imperfect competition, weak rule of law and so on. One more group unwilling to start a new venture is represented by six percent of the respondents. These survey participants find self-employment more attractive than establishment and governance of the company. That allows to suppose that these individuals highly value the opportunity to have more control over their timetable and the activities performed, however they are not striving for the additional responsibilities and potentially higher profit provided by the business venture. Thus, the suggestion is that some of these respondents may once graduate from self-employed into lifestyle entrepreneur, however, likely none of them will ever start high-potential venture. About twenty percent of the respondents are not currently sure about likelihood of new business establishment. These group of respondents does not deny the possibility of becoming an entrepreneur and probably find it attractive at the core, however there are factors restraining their willingness to establish the company.

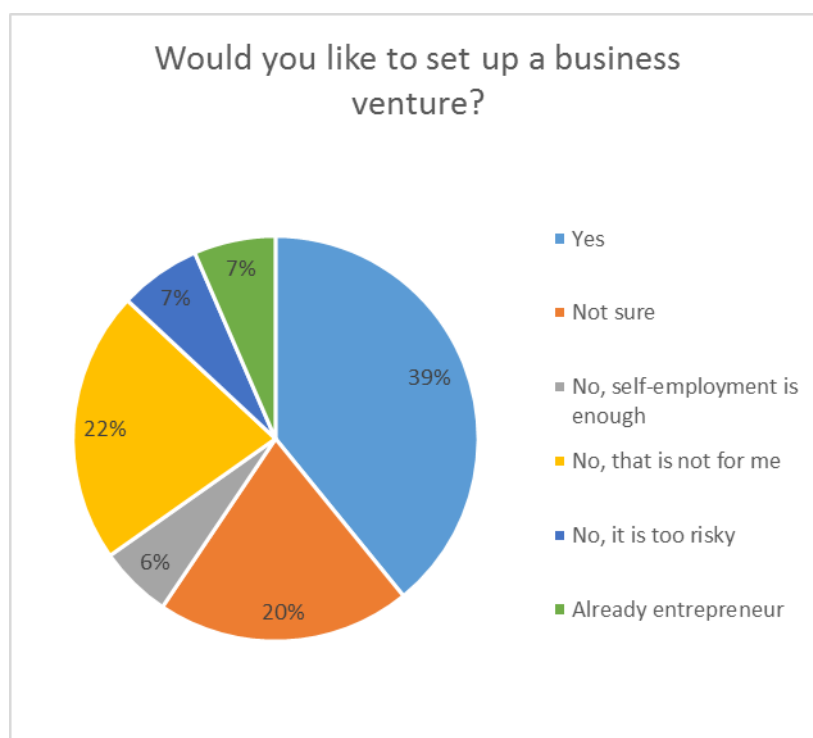


FIGURE 21. Question 9: “Would you like to set up a new business in Russia?”

The following question aimed to study attractiveness of the economic sectors for the potential entrepreneurs. Answers included simplified range of economic sectors divided by the focus of business activity: production, construction, trade, services and agriculture. Sectors connected with the natural resources and energy resources were not included due to amount of the initial financial resources required for the establishment and operations of the business and assumption that participants of the survey might have willingness to participate these sectors but did not have the ability for that. One more answer provided was “none”, if mentioned economic activity sectors do not suit business idea or if a respondent is not interested in any business activity. Thus, 18 percent of the respondents found unattractive all mentioned economic sectors. The following distribution of the respondents’ preferences in economic sectors is represented by the Figure 22. More than a half of all respondents would

start a business related to the provision of services. The second most attractive sector for the business establishment is trade, which was chosen by 16 percent of the respondents. Seven percent of the survey participants preferred production sector and five percent of the individuals would like to have business in construction sector, while as nobody chose the agricultural sector. Unattractiveness of the agriculture might be partially explained by the participation only of the urban population in the survey (unknown); however, it is hardly the single issue of agricultural unpopularity. Type of the business activity, which determines the economic sector for participation, usually depends on the personal interests of the entrepreneur and recognized opportunities, which are formed by the external conditions, and often becomes the issue of benefits and costs relations. Such distribution of the potential entrepreneurs' preferences shows that most of the opportunities and interests are concentrated in the service and trade sectors, while other sectors enjoy much lesser attention. Therefore, there is an interest to investigate the reasons behind the choices of potential entrepreneurs. One of the possible reasons in case of Russia is concentration of the resources in the sectors amenable for the shadow economy, which creates the essence of the greater opportunities within such sectors. Among attractive sectors for unofficial activities are trade, services and construction, while as agriculture is attractive for the large businesses (Eilat&Zinnes 2002, 1237), which corresponds to the results of this analysis of collected data. Moreover, results of the data analysis correspond to the results of the investigation upon distribution of the existing small- and medium-sized business by the economic sectors in Russia. Thus, preferences recognized in the analysis of this survey are not the single occasion but a tendency, which is driven by specific forces.

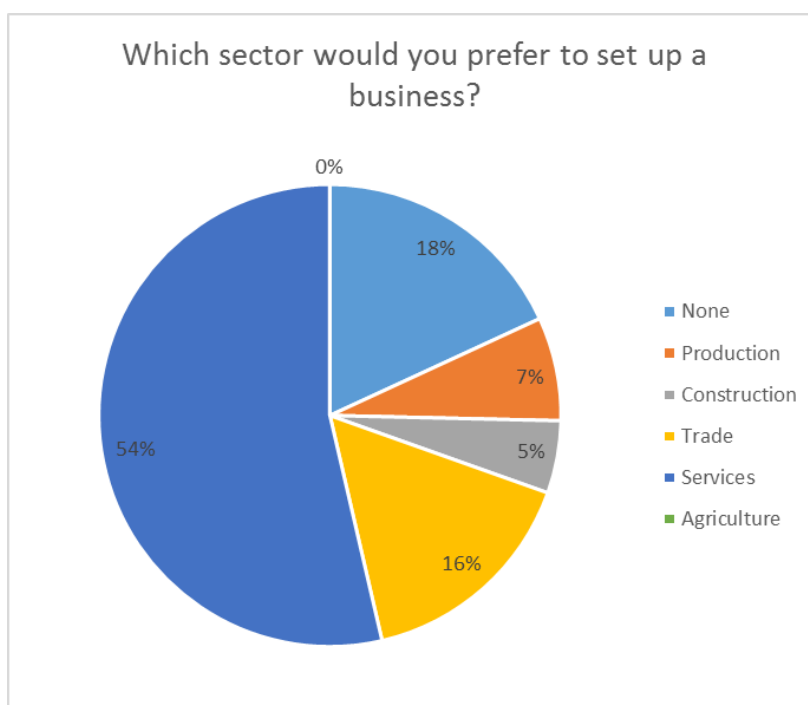


FIGURE 22. Question 10: “Which sector would you prefer to set up a business?”

The next question investigated, what the respondents perceived to be the barriers for the establishment, management and development of the business venture in Russia. The idea behind the question was that investigation of the perceived barriers might provide explanation upon the attractiveness and unattractiveness of the entrepreneurship and, hence, willingness to become entrepreneur. Moreover, exploration and further comparison of the opinions provided by active and potential entrepreneurs might reveal factors, which are restraining entrepreneurship in Russia and factors that may be just stereotypical assumptions, which may hinder entrepreneurial entry. In addition, investigation of the perceived barriers might provide insights on the attractiveness of the economic sectors. Answers included determinants of the economic environment evaluating external threats and the question about educational basis concerning the self-confidence of the potential entrepreneur in ability to govern the

enterprise. The respondents had to choose from the list factors they considered barriers and had opportunity to add their own option in the “other” section. Thus, the respondents believe corruption and difficulties in obtaining investments being the greatest threats for the business in Russia, as about a half of all survey participants reported these factors. About 32 percent of the respondents perceive business establishment as a financially costly and time-consuming process that is a barrier for entry. Bureaucratic circumlocution is believed to be another serious threat for the business establishment and development. Other four determinants of economic environment gained about the same number of answers. Thus, about a quarter of the respondents consider taxes and weak rule of law to be the treats for the business operations, while as state regulations factor was mentioned only by 22 percent of the respondents. Existence of the excessive competition on the market was denoted as a barrier by 25 percent of respondents, however, taking into account the distribution of the firms over the economic sectors, such perception of the competition is not surprising. Potential entrepreneurs in Russia mainly do not believe that lack of education is a barrier for the management and development of business. Such conclusion can be made, as only nine percent of the respondents doubt that success in business activity can be certainly gained without sufficient education. Respondents also provided several other options, which included “all previously mentioned options”, “foreign stereotypes about Russian business” and “lack of self-confidence and fear of failure”.

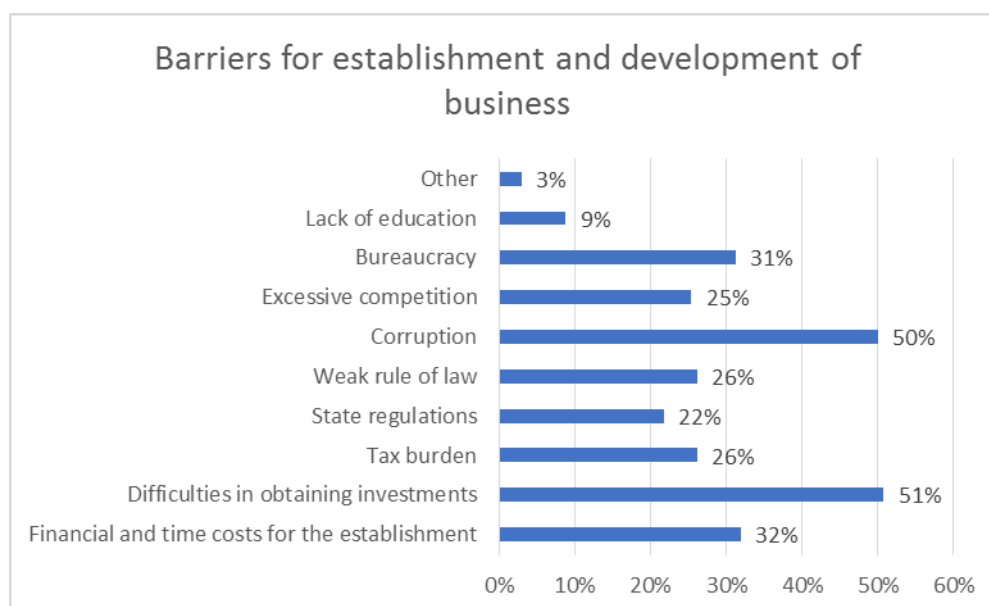


FIGURE 23. Question 11: “Choose option(s) that you believe to be a barrier for the establishment and/or development of a business venture.”

The twelfth question was “Do you regard the opportunity to avoid previously mentioned barriers or to reduce their negative effects?” The aim of this question was to evaluate behavioral morale of the potential entrepreneurs, which might determine the probability of participation in unofficial activities. Sixty-five percent of the respondents replied that they would try to find and utilize the loopholes in order to avoid or decrease negative effects of the barriers, however, only until the available methods are legal. About a quarter of the respondents, believe that it is better to accept the existing situation and to act within it without trying to change it. The rest 15 percent of the survey participants would try to avoid negative effects utilizing both legal and illegal methods. Thus, the last group is more likely would participate the shadow economy.

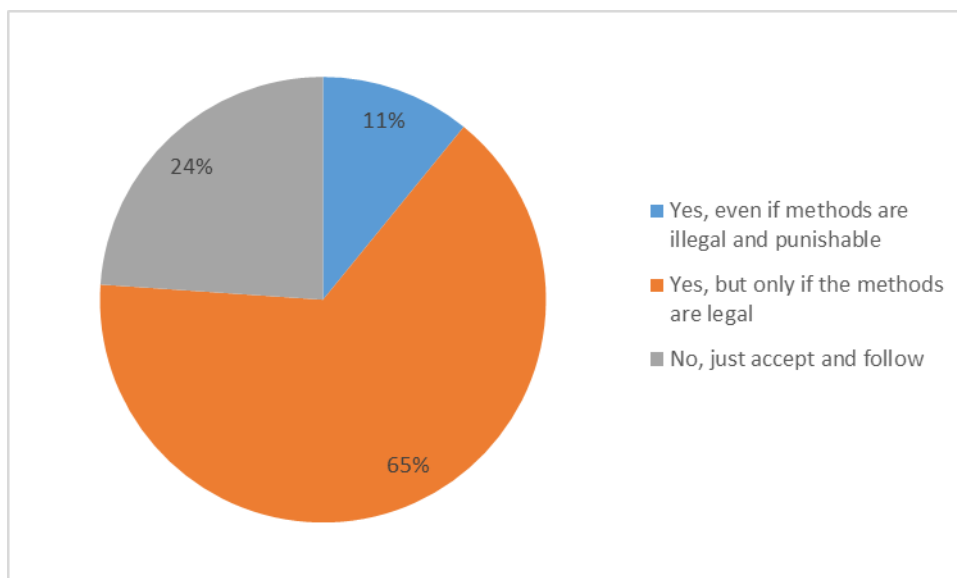


FIGURE 24. Question 12: “Do you regard the opportunity to avoid previously mentioned barriers or to reduce their negative effects?”

The following two questions are investigating the presence of the corruption and possibility to avoid participation in it. Thus, the first question in a topic investigates how frequently and where the respondents or their entourage faced corruption. Only ten percent of the respondents had never encountered corruption. Five percent of the respondents faced corruption activities in the private sector, whereas about 35 percent of the survey participants reported about presence of corruption in the public sector. However, the largest group of the respondents noted that corruption is present everywhere, namely, both in private and public sectors.

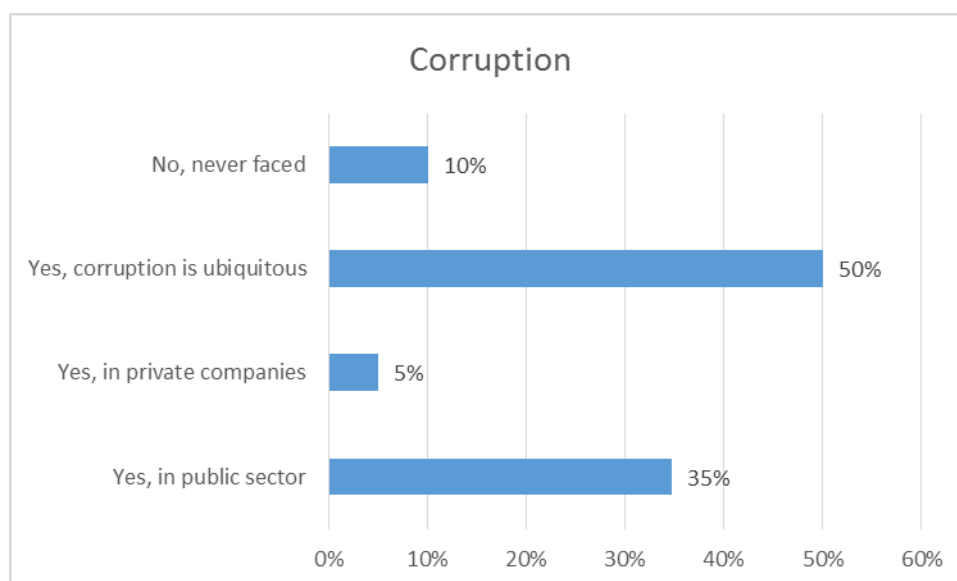


FIGURE 25. Question 13: “Have you or your entourage ever faced the corruption?”

The second question investigating corruption focused on the perception of ability to avoid participation in corruption activities in Russia. The result of investigation is that 14 percent of respondents believe that participation in corruption activities depends on the willingness of the individual, who always has an opportunity to avoid entirely such participation. Thirty-nine percent of the respondents find the possibility to avoid corruption in some business activities, however note the cases, when individual in order to perform the activity and gain some output have to participate the corruption. The largest share of gained responses claims that it is impossible to avoid corruption in business, meaning that if the individual has faced the corruption in the particular business activity, he/she usually has no other option than to participate in it. Such attitudes towards corruption activities show that corruption is widespread and constant occasion in Russian business. Moreover, perceived unavoidability of corruption, which reflects extreme level of bureaucratic arbitrariness and weak rule of law, helps to promote further growth of the corruption through

participation in corruption activities, which once becomes a habit for all participants.

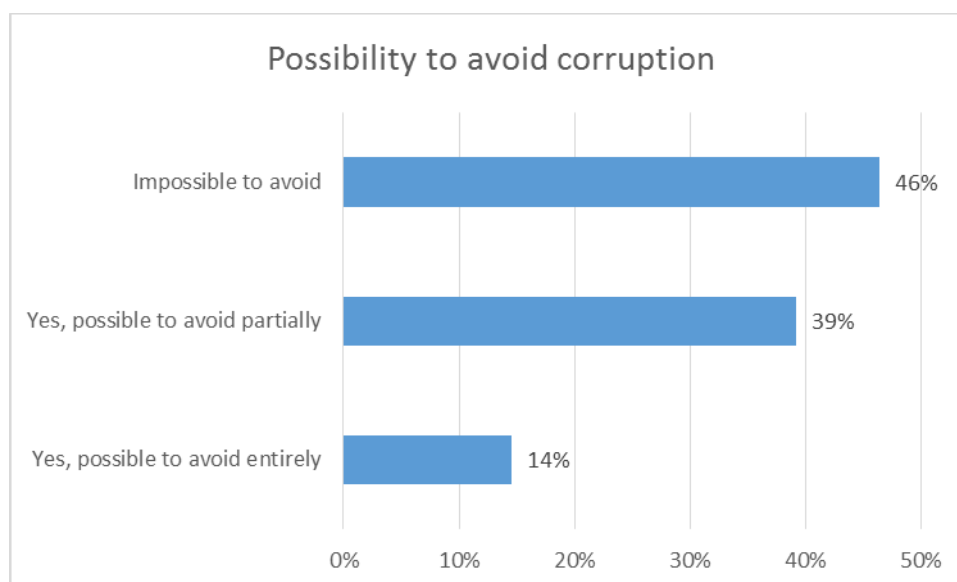


FIGURE 26. Question 14: “Do you believe it is possible to avoid corruption while doing business in Russia?”

The fifteenth question asked respondents to read eight statements and to choose to what extent they were agree with them. The statements and responds are represented by Figure 27. The first statement supposed respondents to look from consumer perspective on the price issues. Seventy-seven respondents were totally agree and 53 respondents were more agree than disagree with the statement. Only eight survey participants were more disagree than agree and nobody was totally disagree with the statement. Such results show that consumers feel that they are constantly overpaying, meaning that consumers are price-takers even though consumer surplus exists in the economy. There may be several reasons why prices are higher on the markets than consumers are

willing to pay. One of them is sanctions, which represent protectionist policy on some markets. Hence, sharp reduction of import made some products scarcer and that caused price growth. However, scarcity is the issue only to some consumer goods, such as agricultural products. Thus, it cannot promote wide price increase on the other markets. Another reason is that reduction of import consequently reduced government revenues and might cause a budget deficit. Taking into account the significant reduction of prices on oil, which is one of the main exported goods, government revenues suffered considerably. Therefore, in order to cover budget deficit government might resort to inflationary financing. Moreover, reduction of oil prices depreciated value of Russian currency, what made prices of imported goods higher. Another impact of reduced oil prices is that oil companies in order to avoid substantial loss in profits raised their prices on domestic market, what influenced other producers and increased cost of production and, hence, prices for many other goods. The important aspect is that significant price increase for the products that are in a surplus is only possible if there is lack of competition on the market. Therefore, it is possible to conclude that prices for natural resources is at least partially the issue of imperfect competition existing on the market. Furthermore, lack of companies in specific sectors allows few participants to increase the prices even more than their production costs has raised.

Thus, several important conclusions can be made. Firstly, monetary policy, budget deficit and imperfect competition increased inflation in the economy. Secondly, inflation, restricted tax system and raised cost of production, in case of further insufficient policies and lack of government support to a private sector, may provoke companies to leave the market, reduce their activity or transfer their activities into shadow. Moreover, due to increased risk and financial resources required lesser entrepreneurial entries may be faced in the economy.

The second statement was examining customers' loyalty to the domestic products. The result was that 43 respondents were totally agree with the statement and 57 were only partially disagree. In contrast, 35 respondents were more disagree with the statement, whereas only three respondents

were completely disagree with the statement. Such distribution of responses shows that most of survey participants would prefer imported goods, whereas, there is mainly no loyalty to domestic products. That fact in its turn reflects that Russian producers are not able to compete with the foreign ones, what leads to the issue of their efficiency. There are several reasons why Russian producers lack efficiency. The first of them is management failure that leads to inefficient resource application. The second reason is a trouble in gaining capital funding, which is needed for the development of operations and raising efficiency. The third probable reason is inappropriate regulations and heavy tax burden, which promote to reduce production operations and focus on other activities, such as renting, or to transfer operations partially into shadow. In case of any listed reasons, the result is poor performance of organizations relying on economies of scale and deterioration of quality of produced goods.

The third statement was investigating how potential entrepreneurs view the distribution of companies by the economic sectors. The results were that 53 respondents believe that the statement is true; while as 56 respondents are more agree than disagree with the provided idea. On the opposite side, 25 survey participants were only partially agree with the statement and barely four individuals were totally disagree. Such results demonstrate that more than half of respondents realize uneven distribution of companies by economic sectors. Interestingly, that even though most of survey participants believe that in some sectors there is excessive number of companies, about 90 percent of respondents continue seeking for opportunities in these sectors instead of focusing on potentially more profitable ones. The only adequate reason for such paradox is that sectors with large number of companies engaged are more accessible for the entrepreneurial entries, meaning costs for entry are lesser. Moreover, it is possible that most of people are employed in these distant sectors, thus it is easier for them to find opportunities within a familiar sector than in another one. However, more research is needed to understand that peculiarity.

The fourth statement was investigating how potential and active entrepreneurs perceive production sector. The results were that 42 respondents were totally agree with the statement, 51 were more agree than disagree, controversially 37 respondents were more disagree with the statement, whereas only eight survey participants were totally disagree. The distribution of answers shows that more than a half of respondents believe that production sector is not developing or development is very slow. The peculiarity here is that provided statement represented the common belief of masses, existence of which was proved by the answers of the respondents. There is high probability that most of survey participants referred the idea of the statement only to a large production companies with own production sites and did not consider small and medium sized companies, the most of which have appeared after the fall of the Soviet Union. Such perception of the production is important itself, as it shows that most of people associate production activities mostly with the ownership of large production sites, which require significant financial inputs to establish. Therefore, most of individuals do not even regard the possibility to start business in production sector, especially if they are not familiar with the concept of outsourcing. One more important conclusion can be made. As belief mainly referred to the large production businesses owning production sites, it is possible to suppose that number of appeared production sites is not very high. The reason for that is lack of financial resources and, probably, demand in some sectors.

The fifth statement regards the perception of respondents towards competition in natural resources sector. The results were that 72 respondents are totally agree with the statement, 53 respondents are only partially disagree and only 13 respondents were more disagree than agree with the statement. Nobody was totally disagree with the idea provided. The results show the belief in monopolization of the industry or at least of the existence of the imperfect competition. Such perception of the industry might reflect the reality. However even if it is not, the perception and large financial resource required restrain potential entrepreneurs from entry into the sector, what creates the fertile environment for the monopolistic

intentions, which, in their turn, negatively affect production sector and pricing in the economy.

Statement number six was investigating tendency to the unproductive activities instead of productive ones. Most of the respondents were totally agree with the statement and 48 respondents were more agree than disagree. In contrast, only 17 respondents were more disagree with the statement and two persons were totally disagree. The results reflect strong intention towards political entrepreneurship recognized by respondents. Such pursuit towards unproductive activities indicates existence of unfavorable conditions for a private entrepreneurship and reports about institutional and policy failure.

The seventh statement examined opinion of respondents upon the distribution of the firms' size existing on the market. Thirty-two respondents were totally agree with the statement, 61 were more agree than disagree, only six individuals were totally disagree and 39 were more disagree with the statement. Such results show that most of the respondents found piece of truth in the statement, however noted that there were exceptions. Thus, recognized in some cases uneven distribution of the firms' size may be referred to the shadow economy's impacts on the market structure. Although, the conclusion's reliability is the issue of the respondents understanding and knowledge of the scope, to which the firms' size is referred, meaning is what they perceive, as medium-sized company is a medium-sized company. Moreover, due to unofficial sector embeddedness into formal economy and troubles with funding for both formal and informal companies, uneven distribution of the companies' size on the market might not exist or might exist due to other reasons.

The last statement was investigating technological innovativeness of Russian business. Results of the investigation were that 37 respondents totally agree with the statement, 48 respondents were partially disagree, 37 survey participants were more disagree than agree with the statement, whereas 16 respondents were totally disagree. Such results show that still

most of respondents evaluate technological development of the country as insufficient. Taking into account highly developed military and space equipment, it is possible to suppose that technological gap is referred to the civil technologies that are created and utilized by the customers and businesses. From that point of view, Russian business might have good potential for the innovations due to availability of creative and skilled individuals. However, innovations are hindered by the unavailability of resources due to inefficient resource allocation in the economy.

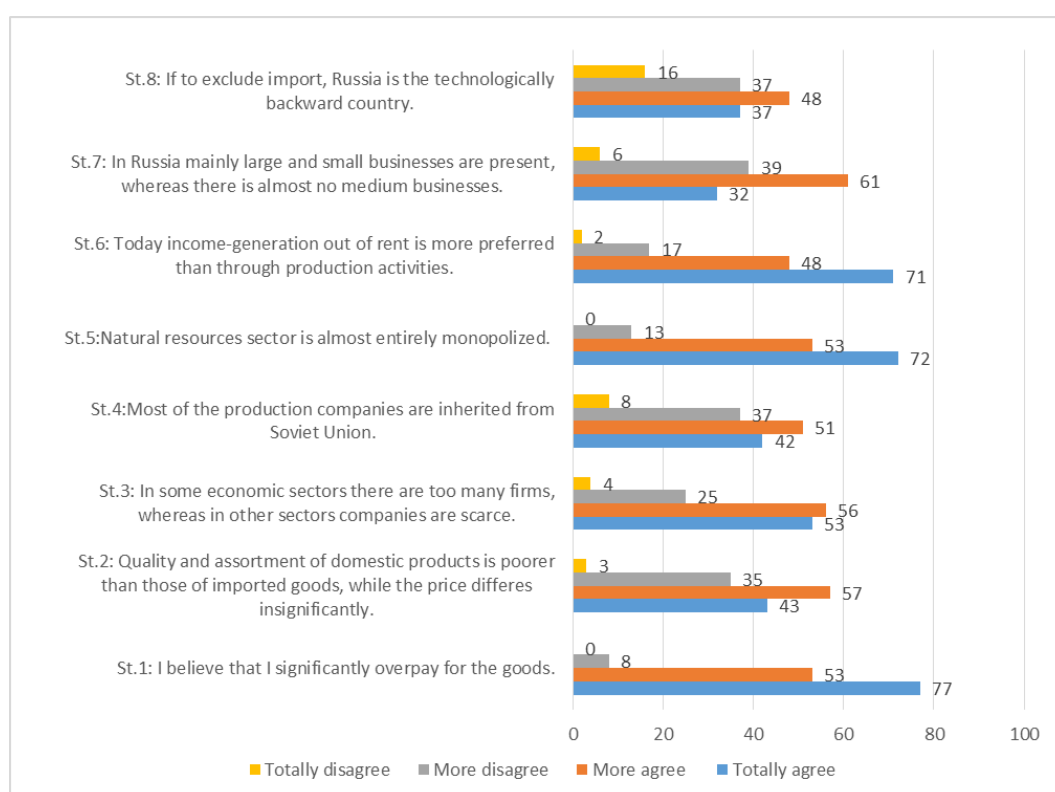


FIGURE 27. Question 15: “Read the statements and choose to which extent you agree with each one.”

Question 16 examined the confidence of the respondents in security of their property rights. The results of the examination are that 41 percent of respondents do not believe that their property is secured, 33 percent are doubting in absolute security and 26 percent are sure that there is no possibility to take away somebody's property without the following punishment. As security of property rights is one of the most important factors promoting entrepreneurship, respondents, who answered "no" or "not sure", perceive the greater risk of becoming entrepreneurs and entire entrepreneurial activity. These respondents are also more inclined to participate the unofficial economy, as unprotected property rights reduce the attractiveness of formal economy.

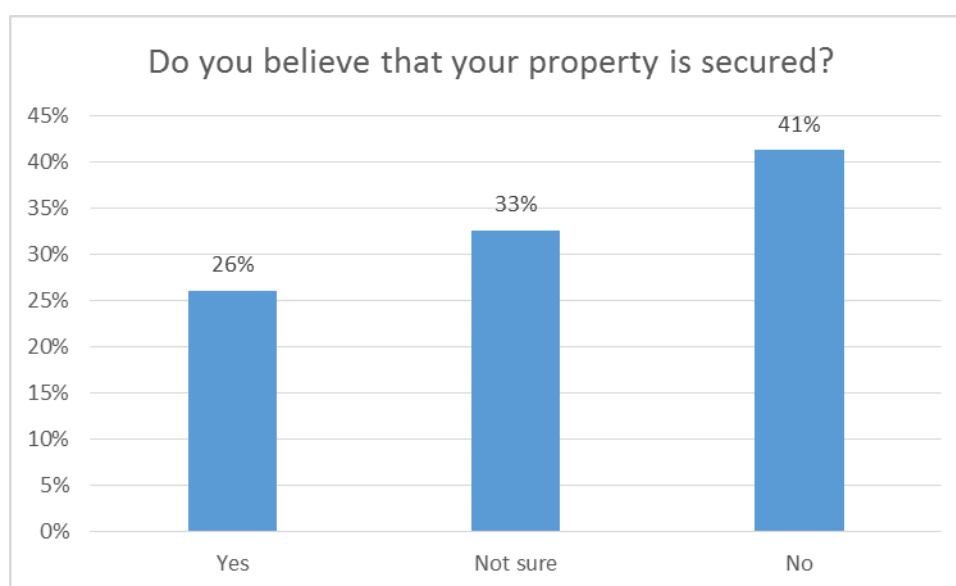


FIGURE 28. Question 16: "Do you believe that your property cannot be taken away by both legal and illegal methods?"

The following question was aimed to evaluate trust of the population towards law enforcement agencies and juridical system. The question

stated was “Do you believe that most of offenders will be caught and punished impartially and according to the law, including statesmen and business elite?” Over 70 percent of the respondents answered “no”, other 21 percent chose “probably”, whereas only seven percent answered “yes”.

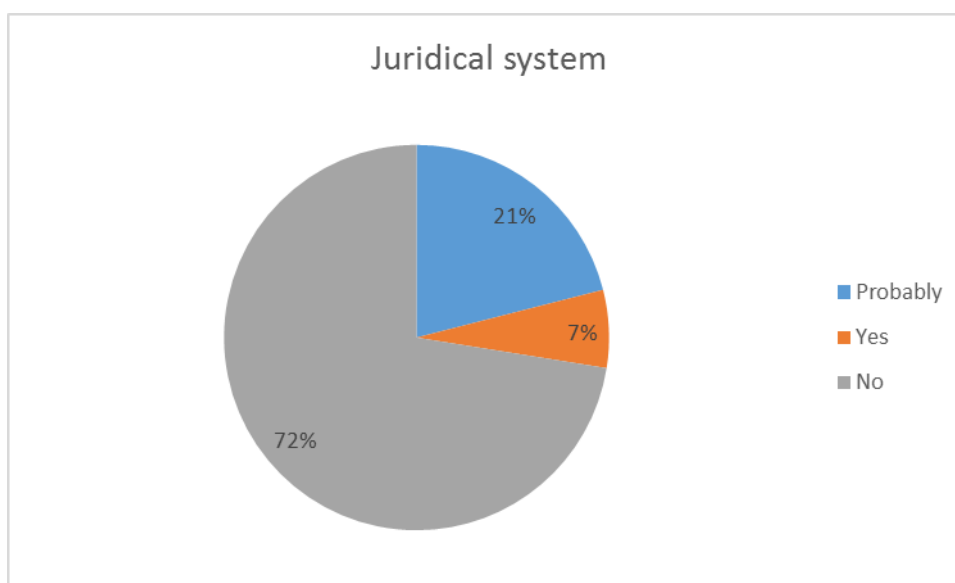


FIGURE 29. Question 17: “Do you believe that most of offenders will be caught and punished impartially and according to the law, including public officials and business elite?”

Such distribution of opinions shows general distrust towards law enforcement agencies and juridical system. Therefore, it is possible to assume that most of the respondents treat juridical system as biased, enforcement of law as poor and overall rule of law as weak. It is also possible to conclude that prevailing attitude may reflect the reality. Furthermore, as rule of law is an important factor promoting entrepreneurship, such attitude towards juridical system and law enforcement agencies may hinder the willingness to take the risk and

enter the market as an entrepreneur or may provoke the entry in the unofficial instead of official economy. In addition, general distrust towards particular institutions may develop into distrust towards the entire government.

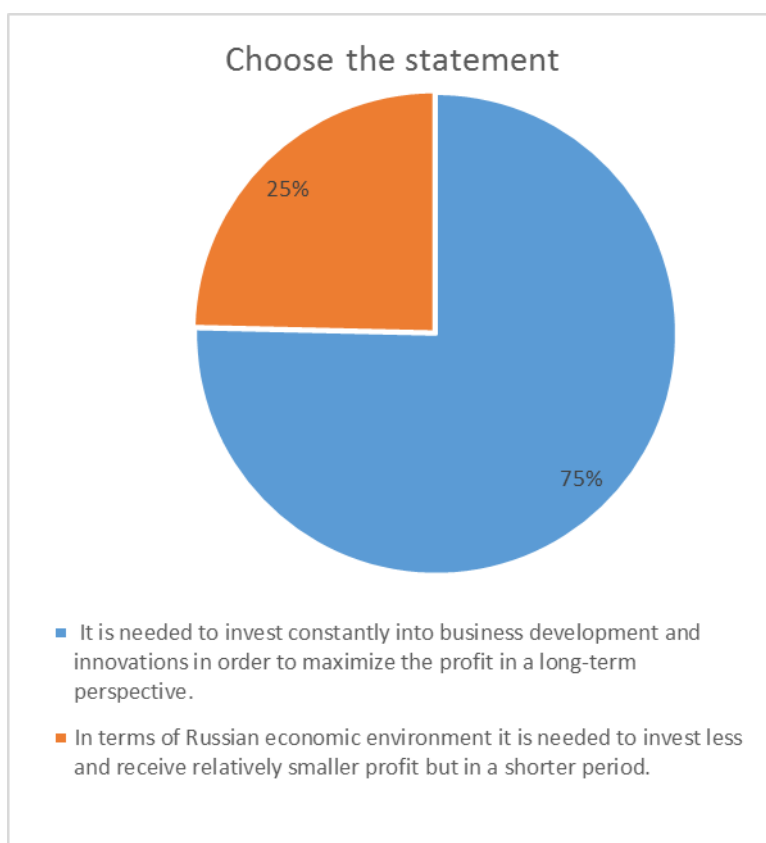


FIGURE 30. Question 18: “Choose the statement that you believe to be correct.”

The last question of the survey examines the focus of the respondents on either short-term or on a long-term orientation in business management. Most of the respondents believe more advantageous to focus on a long-term perspective in business activities, instead of a short-term.

7.2 Empirical Investigation: Regression Model

Observation of the survey results provides insights for the further research and well describes major perceptions and habits existing within the population. However, the results not explain the differences in the perceptions, the same as their influence on the attractiveness of entrepreneurship. For these reasons, the second stage of survey analysis involves multinomial logistic regression model.

7.2.1 Multinomial Regression Model

Before building and testing the model, collected data is re-assured and transformed into appropriate sample. In order to investigate factors affecting entrepreneurial intention, Willingness to become entrepreneur (further called "Wil.") is stated as dependent variable with the levels "No" (no willingness), "Yes" (willing to become) and "Already" (active entrepreneur). Among regarded predictor variables were Age, Work experience, Evaluation of institutional efficiency, Number of perceived barriers, Perceived ability to avoid barriers, Perceived ability to avoid corruption activities, Perception of existing competition, Perceived security of property rights and Perceived efficiency of juridical system. Trial of the first model showed it inefficient that led to the reshape of the model. Variable of work experience was excluded from the final model due to missing values. Variables representing possibility to avoid corruption and opportunity to avoid recognized business barriers constituted a new variable.

Final model included seven predictor variables and one dependent variable. All variables are nominal constituted by three categories each. Number of categories within variable was one of the main reasons for utilizing multinomial logistic regression. The first predictor variable is Age, which includes categories "Youth" (for 18-25 aged respondents), "Adult"

(for 26-45 years) and “Midage” (from 46 years). The second variable is Institutional Efficiency (Inst.) with categories “bad” (score 1 or 2), “satisfactory” (score 3 on Likert scale) and “good” (scores 4 and 5). The third predictor variable is Number of perceived barriers (Barr.) and includes categories derived from the total number of recognized barriers by the respondent – “low”, “medium” and “high”. Variable Avoidance (AvoiD.) united Perceived ability to avoid barriers and ability to avoid corruption activities. Categories within variable are “No” (following regulations), “Legally” (only legal avoidance acceptable) and “Yes” (for any possible method to avoid). Variable Competition (Com.) consists of categories “low”, “medium” and “high” that are based on the total score gained for the answers on survey question 15. Baseline for the dependent variable Wil is category “No”. Referent levels of the predictor variables:

- Age – “Adult”
- Inst – “Bad”
- Bar – “Low”
- AvoiD – “Partially”
- Com – “Low”

Estimated null hypothesis (H_0) is that there is no relationship between Y (dependent Wil. variable) and X (predicting) variables at significance threshold $\alpha = 0,05$.

Current model has several limitations, affecting reliability of obtained results. Firstly, sample is not large enough to be generalized. Secondly, although the model was restricted, there is still need to consider multicollinearity effects due to natural interrelation between predicted variables. Thirdly, although some potential predictor variables were removed from the model, as gained results were not significant, there is still possibility of underestimate.

7.2.2 Results

Multinomial Logistic Regression revealed only two statistically significant relations, yet absence of the relations is more a good than a bad sign. One of the proven relations reveals that desirability of a business venture falls

after 46 years (Midage). Significant log odd (Coef. = -1,9029) shows that attractiveness of entrepreneurship decreases to 13% of the individuals after 46 years, who still find entrepreneurial activity desirable. Another significant coefficient (Coef. = -1,7376) illustrates that probability of being active entrepreneur is only 15% for the individuals, who is 18-25 years old, however, the result is not statistically significant ($p = 0,1243$) primary due to the small population sample, especially lack of respondents – entrepreneurs.

Table 4. Multinomial Logistic Regression Results (* $\alpha=0,05$; ** $\alpha=0,1$)

	"Yes"				"Already"			
	Coef	Std.Er	z	p	Coef	Std. Er	z	p
(Intercept)	0,275	0,858	0,321	0,749	-0,8733	1,2662	-0,6897	0,4904
Age. Midage	-1,903	0,849	-2,242	0,025*	-0,8534	1,2025	-0,7097	0,478
Age.Youth	0,254	0,3996	0,6365	0,5245	-1,7376	1,1304	-1,5371	0,1243
Inst. Satisfactory	0,342	0,4049	0,8438	0,3988	0,0824	0,7943	0,1037	0,9174
Inst.Good	1,766	0,847	2,085	0,037*	1,241	1,5272	0,8125	0,4165
Bar.Medium	0,512	0,45	1,1385	0,255	1,5203	0,8778	1,7321	0,0833**
Bar.High	-0,651	0,743	-0,875	0,3815	0,6354	1,2589	0,5047	0,6138
Avoid.No	-0,303	0,4589	-0,6603	0,509	0,4646	0,875	0,5309	0,5955

Avoid.Yes	- 0,9525	0,967	-0,985	0,325	0,2307	1,2872	0,1792	0,8578
Com.medium	- 0,8524	0,8221	- 1,0369	0,3	- 2,0543	1,214	- 1,6922	0,0906**
Com.high	- 0,8826	0,8688	- 1,0158	0,3097	- 1,3094	1,2408	- 1,0553	0,2913

Interestingly that there is almost no difference in coefficients, when institutional efficiency is evaluated as poor and when it is perceived satisfactory. However, probability increases up to 85% (Coef. = 1,7662), when institutional efficiency evaluation changes from “poor” on the “good” one, revealing significant increase in entrepreneurial intention. Probability also increases significantly for entrepreneurial entry (Already ~ Inst.Good), however large p-value (0,4165) shows result is unreliable.

Large coefficient (1,5203) for the relation between perceived barriers for entry and active entrepreneurship shows that most entrepreneurs recognize rather big number of barriers within economy, much more than the other survey participants. Coefficient was found statistically significant at the significance threshold $\alpha=0,1$. Surprisingly, no significant relations were found between willingness to become entrepreneur and Barrier avoidance. Moreover, alternatively than was expected, there is a slight decrease indicating that most individuals, who have entrepreneurial intention believe inappropriate to utilize unofficial and illegal methods for the cost reduction.

The last predictor variable in the model was competition. The result of regression shows significant decline of the probability in being in the group “Already”, when low score on attitude towards competition is replaced by medium score. Slighter decline is also present if low score is replaced on the high one. Even if the last result is statistically insignificant, the previous falls before significance threshold of $\alpha=0,1$. This shows

substantial differences in perceptions of active entrepreneurs and other population to the domestic competition.

Other factors revealed no influence on formation of intrepeneurial intention and showed no difference in perceptions of entrepreneurs and non-entrepreneurs.

8 DISCUSSION

Research on the attitudes towards opportunity of potential entrepreneurs revealed that significant part of the investigated population find entrepreneurial activity attractive and desirable. Investigation of the entrepreneurial development within the case country showed that economy is suffering from inefficient resource allocation and uneven development of economic sectors. Theory supposes that when large shadow economy is present resources are gravitated towards shadow sectors. That can be clearly visible from the answer of respondents about attractive economic sector. Services and trade were the most commonly chosen options.

One of the greatest challenges for the business establishment and operations revealed is availability of capital funds. According to the Economic Freedom Index, Russia has very low scores on the financial and investment freedom. Gathered primary data both through interviews and though survey evidenced the problem of hardly accessible capital to realize existing entrepreneurial intention.

The aim of empirical part of the study was to answer two sub-questions: “How shadow economy influences willingness to start a new business and mindset of active and potential entrepreneurs in Russia?” and “What are the prospects for development of entrepreneurship in Russia in the next few years?” In order to answer the first referred question, investigation includes three parts. The first is how non-entrepreneurs perceive entrepreneurial activity and existing business environment. The second is how perceptions of non-entrepreneurs differ from the perceptions of active entrepreneurs. The third is what effects of shadow economy can be recognized on the attitudes and willingness to start entrepreneurial activity. Summarizing and interpreting obtained results help to estimate prospects for the development of entrepreneurship in Russia for a next few years.

While observing perceptions of non-entrepreneurs there are couple important results affecting willingness for entrepreneurship to note. The

first, decrease in entrepreneurial intention among observed population after 45 years old. One of the possible explanations for such result is that risk averseness increases at older age, the same as perceived risk of failure. Thus, older individuals are unwilling to take the risk, which accompanies entrepreneurial activity. Another explanation, which may exist in Russian case, is that older people are more critical to the business environment and more distrustful towards current political system and government than younger generation. That may occur due to greater negative life experience gained from earlier historic events. This estimation is indirectly supported by the estimates from the interviews, where older interviewees demonstrate more distrust and negative attitude towards official institutions and government than the younger one.

The second important result is perception of institutional quality. Perception of high institutional efficiency significantly increases willingness to become entrepreneur. Through affecting perceived feasibility, this factor has highly positive influence on formation of entrepreneurial intention.

Interestingly, that amount of perceived barriers has not revealed such a strong influence on the entrepreneurial intention as high institutional efficiency. That allows supposing greater attractiveness of entrepreneurship, hence, more frequent entrepreneurial entry, if population perceives institutions highly efficient even if number of the perceived barriers stays the same or increases. Thus, inefficient institutions and poor quality of public goods are the main source of uncertainty for population and, consequently, the main risk for doing business in Russia. The revealed attitude may be dictated by the environment of general distrust towards official institutions that is typical for economies with large unofficial sector. Although amount of perceived barriers have not revealed influence on entrepreneurial intention, it showed difference between perceptions of barriers between entrepreneurs and non-entrepreneurs. Potential entrepreneurs were found to have slight misconception about business environment and its flaws. Research showed some underestimation of barriers for business among non-entrepreneurs in comparison to active entrepreneurs. The latter recognize

more barriers, although do not either exaggerate them, thus in average gaining the medium score, while majority of non-entrepreneurs perceive only little amount of barriers. That fact may evidence about little awareness of the population about activities and problems within business sphere and existing unrealistic (more positive) image of entrepreneurial environment. That interpretation also corresponds to the previous finding: widespread underestimation of the environmental business hurdles decreases number of perceived problems positively affecting feasibility, hence, formation of entrepreneurial intention. Potential entrepreneurs do not see and feel themselves the signs of existing problems within business sphere that much as active entrepreneurs. Thus, it seems to them (non-entrepreneurs) as no real problem exists that is a direct result of a lacking awareness, besides experience, about market and business activities. At the same time, ordinary people can easily feel disadvantages of the institutional performance on a daily basis, viewing those inefficiencies a greater problem firstly because they are aware about existence of this problem.

There is another evidence that the majority of interrogated non-entrepreneurs sees only the tip of the iceberg of business activities. Russian economy has been facing dramatic recession since 2014. Negative economic conditions partially reduce attractiveness of entrepreneurship and number of entrepreneurial entries in times of economic recession. The issue is that unfavorable economic conditions make it harder for creative individuals to implement their business ideas. Therefore, many nascent entrepreneurs have to delay entries until economy recovers. However, that is referred only to the people with initial desirability of entrepreneurial activity and formed entrepreneurial intention. Another case if individual does not have perceived desirability of a business venture. In this case, economic recession affects perceived feasibility of entrepreneurship hindering formation of intention. The survey run in times of recession revealed large share of individuals demonstrating entrepreneurial intention (about 40%) in comparison to smaller groups of those, who perceive entrepreneurship to be too risky (7%) and those, who

do not have the certain willingness yet (20%). In combination with underestimated barriers there is a probability that individuals may overestimate own capabilities or do not regard their willingness in connection with economic situation and business obstacles. In case of latter, these individuals demonstrate not a certain intention but more a hypothetical wish, while as they hardly regard themselves as an owner-manager. Finally both interpretations evidence about simplified and rather naive perception of a business reality that is basically a result of general unawareness and inexperience of a population in the sphere of private business.

Within large shadow economy, it was surprising to find, that majority of individuals (both entrepreneurs and non-entrepreneurs) regard avoidance of barriers only by legal methods. That evidences about general law-abiding attitude of the population. One explanation of such result is that most of the participants of the survey are younger generation (less 35), which is less critical to the institutional system than older generations, as was assumed on the basis of analyzed interviews. Hence, younger people are less inclined to avoid regulations through unofficial sector than those, who have already experienced that earlier in life. However, that is not the only possible explanation. If to pay attention at the tax payment habit of the population, majority of the respondents do not pay taxes fully (43%) or do not pay them at all (15%), while as tax avoidance is illegal. Such contradiction between attitude and behavior raises the question of what people perceive to be legal. Webb et al. (2009, 492) in their study "You Say Illegal, I Say Legitimate: Entrepreneurship in the Informal Economy" state that laws and regulations are the product of the large social group's values and norms. At the same time existence of two large social groups within a particular society produces two different sets of norms and values. When one these sets of norms becomes a formal law, the other continues its existence within initial group. Therefore, there is a gap between the one consider legal (law) and legitimate (informal set of norms). A situation, when something that is illegal may be legitimate in society, is also highly possible. (Webb et al. 2009, 492.) That situation is the issue of a long-

lasting presence of large shadow economy. Thus, considering contradiction in the research results it is possible to assume that respondents, specifically non-entrepreneurs, may unconsciously substitute legality (“legal”) for legitimacy (“legitimate”). The idea behind the assumption is a complexity of a legislation and little awareness of an ordinary individual about what is in fact legal. Thus, without specific knowledge and own experience, individual at first relies on his own understanding of legality based on widely known laws, social and personal norms and values and experience of social nets. Thus, individual may not even realize that he is breaking the law at some point, until the opposite is proven to him. This little awareness of law peculiarities and substitution of legality for legitimacy may cause wrong evaluation of chances for completely legal business operations. This could be the one explanation to the occurred contradiction of results. Another explanation is that business activity is accompanied by the risk and requires more responsibility. Therefore, unofficial activities as another source of risk should be avoided whenever is possible.

The estimation of little awareness of population in legal sphere and economic and business processes is also supported by the investigation results of what respondents perceive to be a barrier for doing business. Only eight percent of the respondents recognized lack of education as a barrier, while as education is a proven factor affecting formation of entrepreneurial intention and entrepreneurial success. Such low number of individuals recognizing role of education in business activities points at either a belief in high level of education among population in general or overestimate of own capabilities. Both of the perceptions consequently lead to the appearance of gaps in required knowledge and skills, as there is no perceived need in education. Perception of unrequired additional education for business activities in complex with low general awareness of the population about environmental (business) aspects may be an explanation for little visible effects of shadow economy on mindset of individuals.

The last issue observed in Regression Model was competition. Although, majority of population recognizes different effects of shadow economy on the nature of competition, no statistically significant influence is found on entrepreneurial intention in relation to perceived market structure and perceived market conduct, the same as no difference was found between perceptions of entrepreneurs and non-entrepreneurs.

Summarizing effects of shadow economy on the mindset of the population it is needed to consider the influence of other factors. Thus, almost inherited distrust towards government is still recognizable among population; however, among younger individuals it is much lower. This is because people younger than 46 years old have lesser reasons for a distrust than older people do. People over the age of 46 began their economic activity under communist system, therefore they have experienced as adults and economic agents negative economic conditions and massive informal and illegal activity right before and after the decay of the system. These system changes in complex with heavy long-lasting recession and widespread shadow and criminal activity transferred from USSR provoked emergence of total distrust towards any political system. In fact, decay of communist system was predetermined due to its inability to satisfy economic needs of the country and restrain private business activity carried out unofficially. Large shadow economy then developed new set of informal institutions, which formed the basis for current legislation. In comparison to the shadow economy of those times, present informal sector does not have such dramatic effects and is just an unavoidable consequence of yet undeveloped political system. Therefore, younger generations do not have the same experience as older people, hence, do not have the same depth of distrust but an echo of earlier experience delivered through social nets. That is why the majority of people today are more opened to entrepreneurial activities and believe in legal ways of doing business.

Besides some positive tendency in entrepreneurial development, it would be a mistake to underestimate flaws of institutional system and effects of unofficial sector today. Firstly, it is needed to regard so called "communist

heritage”, namely, oligarchic elite, which controls state officials, massive corruption also within juridical system, weak protection of property rights and low quality of public goods. These aspects of existing system are the initial reasons for a still large unofficial sector. Secondly, undeveloped and overregulated financial markets and strict investment laws are the factors hindering entrepreneurship and preventing reduction of unofficial sector. Until these two groups of factors are taken under control, it is not possible to expect a breakthrough in development of entrepreneurship and decrease in shadow economy’s size.

It is also *not possible* to estimate significant decrease in attractiveness of entrepreneurship among population in next several years. The reason for that is mitigation of factorial negative effects, occurred due to general inexperience of population in activities within capitalist system. That inexperience is determined by the novelty of the system of norms and values of the capitalistic society and the lack of accumulated social experience in existence within the system built on the idea of private property. Moreover, mixture of dictated capitalistic values and already established values of the communist society usually contradict and replace each other. Therefore, majority of population have vague idea of what is right and what is wrong, for example recognizing still little difference between secured or unsecured property rights.

The direct result is unawareness of the population about peculiarities of business and legal environments, especially if legislation and regulations are volatile. That feature at some point mitigates negative effect of institutional inefficiency reducing level of possible discontent, hence, loss of entrepreneurial attractiveness and transfer to unofficial sector. At the same time, absence of clear informal norms makes individuals to rely heavily on what they believe to be norms and experience of others. While as experience of others if was obtained through social nets may also include practices of unofficial activities, which transfer to the taker. That is why shared social experience (inexperience) with the mixture of unclear norms and personal beliefs that determine legitimacy today and little awareness in legal environment provoke substitution of legality for

legitimacy among population. That results in engagement in unintended and unrecognized unofficial activities, thus supporting the size of informal economy. Moreover, as only small part of population has experience in business activities, new entrants have to investigate the sphere from the very begging themselves and the risk of failure increases.

Another effect of shadow economy on the mindset of entrepreneurs is recognition of the opportunities mainly within non-productive sectors amenable for informal activities. Thus, the most attractive sectors are service sector and trade.

Although the majority of younger population find entrepreneurship an attractive activity, it is not possible to expect high paces of entrepreneurial development. Problems in obtaining finance and little social experience in entrepreneurship, hence, increased risk of failure restrain number of entrepreneurial entries and entrepreneurial successes. However, decrease in perceived attractiveness of entrepreneurship among population is also improbable in the next 3-5 years.

As Russian business and entrepreneurship are in process of formation of own “business culture” and norms and population lacks experience in this sphere of life but already finds it attractive, it is the most appropriate time for supporting entrepreneurship, simplifying the process of business entry. Thus, if finances become easily accessible, entrepreneurial participation rate is highly expected to face significant growth.

9 CONCLUSION

This chapter summarizes the information gathered throughout the research. It covers the main aspects of the study and research process and the answers stated research question and sub-questions. The chapter also discusses reliability and validity of the research and provides suggestions for further research.

9.1 Answers to Research Questions

This section provides the answer to the main research question, which was stated as: **How does presence of shadow economy affect entrepreneurial mindsets and entrepreneurial development in Russia nowadays?** Due to the complexity of the main research question a number of sub-questions were asked. The author sees it to be reasonable to provide answers to the research sub-questions first while the main research question is answered at the end of this section.

What is shadow economy?

Shadow economy is any economic activity that is performed without reporting official institutions. Shadow economy includes activities that may be legal but avoid control of relevant institutions or activities criminal in core. Thus, shadow activities are divided into informal and illegal. Observed in this study informal activities occur primary due to inappropriateness of state regulations and institutional inefficiencies, burdening economic agents. From that point of view, shadow economy is the other side of the official economy that supports economic activity through providing more choice opportunities for economic agents. Large informal sector has several important characteristics and effects on the official economy. Firstly, due to the nature of hidden activities, presence of large informal sector negatively influences macroeconomic decisions of the state. Secondly, due to the same reason, it causes microeconomic inefficiencies, as investment decisions of business owners. As the consequences may be irrelevant macroeconomic policy, distortions in

resource allocation, deteriorated capital and financial markets, increased regulatory burden and monopolistic in the economy. Thirdly, large shadow economy develops and is regulated by informal set of institutions and norms, which start to replace official ones within society. Finally, widespread informal economy provokes the emergence of distrust among population towards government and existing political system. Moreover, informal economy usually associated with corruption. Besides, negative consequences shadow economy acts like a safety net for keeping economic activity, especially in times of economic recession. For the transition countries, shadow economy is unavoidable due to occurring systematic change.

How is shadow economy related to entrepreneurship?

Entrepreneur is an economic actor, who makes the decision to start or to stop unofficial operations. As decision is made because of irrelevance of regulations that significantly complicate business operations and reduce profit, institutional framework is the reason for appearance and development of informal sector. Unofficial activities are economic activities that considered unofficial only due to the norms outlined by the current legislation and policy. The fewer regulations and restrictions, the less activities considered informal. Although entire absence of regulations is not possible, there should be developed a policy that minimally restricts freedom of economic actors. The policy of Economic Freedom is a type of policy that provides wide opportunity to choose for economic agents and enforces limited interference of state into economic activities. Therefore, such policy is characterized by very small informal sector, as economic actors do not have reason for operating unofficially.

Relationships between economic agents, hence, entrepreneurs, shadow economy and institutional framework are dynamic. Thus, institutional frameworks initially provokes economic agents to transfer activities into informal sector. Shadow economy is growing and affects official economy. Due to shadow economy's effects on the economic performance, state revises policies and regulations. Furthermore, economic and institutional

environments affect development of entrepreneurship, as they are taking part in shaping individual's attitudes towards entrepreneurship, perceived feasibility (sense of self-efficacy) of a new venture, process of business establishment and administration, and probability of entrepreneurial success. Therefore, it is possible to assume shadow economy affects the formation of entrepreneurship through the individual's perceptions and develops some peculiarities of thinking among active entrepreneurs.

How does shadow economy influence willingness to start a new business and mindset of active and potential entrepreneurs in Russia?

Underground economy of the USSR provoked change of the political system that resulted in total distrust of population towards any political system. Although today, people younger than 46 years old do have that depth of distrust towards government, hence, towards official entrepreneurship. Despite that decreased effect, in times of systematic change and inexperience of population in capitalist environment, long-lasting shadow economy have made unofficial practices in all spheres of life a normality. Therefore, individuals sometimes do not even recognize unofficial activities, as unofficial. That normality of informal operations and unawareness of population in legal and business issues mitigate negative effects of institutional flaws on the formation of entrepreneurial intention. Active entrepreneurs rather often take part in unofficial activities; however, they start to recognize opportunities for completely formal operations avoiding unofficial sector. Majority of potential entrepreneurs in their turn believe in entirely legal business operations and reject any opportunity of unofficial activities, however such view is rather naive. Another recognized effect of shadow economy is massive recognition of business opportunities primary in economic sectors amenable for informal activities.

What are the prospects for the development of entrepreneurship in Russia for the next few years?

The survey revealed large share of people with entrepreneurial intention. However, these individuals are not able to implement their ideas due to the difficulties in obtaining necessary finance, which were recognized the major barrier for business entry and development in Russia. Therefore, until capital funding becomes easily available, there will be no massive entrepreneurial entries. Another factor hindering entrepreneurial intention among population is low institutional efficiency and rather poor quality of public goods. The final factor is general social inexperience in business activities due to which individuals have no access to social knowledge accumulated by previous generations but have to collect necessary knowledge and investigate peculiarities of business administration on his own. Thus, expected number of entrepreneurial failures is very high. Based on the noted conclusions and taking into account economic situation in Russia it is possible to assume growth in number of entrepreneurs in a next few years. Growth of entrepreneurship is especially probable after economy will start to recover. Although growth of entrepreneurship is expected, it will not be fast, as the main problem of hardly accessible capital is also expected to be present. It is also possible to assume a beginning of the process of reducing unofficial activities among entrepreneurship due to development of knowledge about opportunities offered by formal institutions and initial law-abiding attitude of new comers.

How presence of shadow economy affects entrepreneurial mindsets and entrepreneurial development in Russia nowadays?

Legislation determine official and unofficial economic sectors. Any economic activity that is performed not in accordance with the legislation is unofficial activity. Unofficial economy may be criminal (against criminal law) or informal (avoiding record and control). Informal economic activities are economic activities that are not regulated by official institutions. When shadow economy is large, informal set of institutions are developing within it and regulate it.

Decay of the USSR due to inability of the political system to satisfy economic needs of the country and widespread shadow economy marked the period of transition to the capitalist system. The transition is still in progress, while the beginning of the process has several important characteristics influencing the following stages of transition. Firstly, beginning of transition was accompanied by disintegration of social norms and values. Secondly, the process of transition was not planned carefully, thus, new institutional system occurred undeveloped and impractical. Moreover, informal institutions developed by shadow economy of USSR became the base for a new legislation. In addition, new legislation and transition process were constructed in accordance with the interests of a particular social group. Thirdly, transition was accompanied by massive economic recession and criminal and informal activities that provoked emergence of total distrust among population towards new political system. Distrust and poor economic conditions restrained official entrepreneurial activities but promoted large unofficial ones.

Disintegration of social norms caused formation process of a new system of values and norms based on the mixture of capitalist and socialist values and informal norms developed under shadow economy. Due to contradicting nature of capitalist and socialist norms, volatility of legislation and widespread unofficial sector, informal "shadow" norms took the central place in guiding individuals within economic environment. The effect was strengthened by the lack of social experience in private business activity. Inexperienced population with no clear understanding of right and wrong in context of market economy is unable to evaluate adequately performance of official institutions. That aspect in complex with large unofficial sector and decreasing distrust towards government due to passed time mitigates negative effects of institutional flaws. The mitigation effect and increased life standards promoted attractiveness of entrepreneurship, increasing number of individuals with entrepreneurial intention.

Decreased distrust towards government created more law-abiding attitude among population. However, still volatile and complicated legislation, habitual unofficial activities and institutional and regulatory inefficiencies

restrain entrepreneurial development. Besides those problems, social experience in business administration accumulated during the past two decades and development of official institutions provide opportunity for the legal business operations. The entrepreneurs have recently recognized that opportunity. However, transfer of operations from unofficial back to official sector will take some time.

Summarizing the effects of the shadow economy on the entrepreneurs, they are normality of unofficial activities, guidance of business activities by the informal institutions and mitigation of perceived environmental risks. The results are obtainment of business experience and knowledge required to operate officially and little affection of institutional defects on the formation of entrepreneurial intention for official entry. However, still potential entrepreneurs recognize business opportunities mainly in non-productive “shadow” economic sectors.

Thus, from this point of view entrepreneurship has positive prospects for the development. Increase in entrepreneurial participation rate year over the year is highly possible. However, paces of growth will be restrained by difficulties in obtaining finance for establishment and development of business. Moreover, even though a number of the entrepreneurial entries increases, entrepreneurial failures will significantly overweight entrepreneurial successes due to the still lacking experience and the inadequate notion about conditions of business and legal environments.

9.2 Reliability and Validity

The main goal of the research was to provide answers to the stated research questions, which was achieved. The research utilized both primary and secondary data. Secondary data was obtained from the books, scientific articles, research papers and federal statistical publications. Collection of primary data was exercised through the interviews with entrepreneurs and through electronic survey. Although

research questions were answered, several aspects of research reliability and validity have to be mentioned.

At first, responses to some of the survey questions may have different interpretation due to peculiarities of individual understanding of the questions, as the issues for investigation were attitudes and perceptions. Secondly, rather small number of survey respondents, in particular little number of interrogated entrepreneurs, made impossible to gain highly reliable results from Logistic Multinomial Regression. However, those results that were found statistically significant are supported by the other empirical findings of the research and historical context of the case country. Therefore, these findings cannot be regarded as undisputable facts but may serve as theoretical estimations for further researches in this area. Thirdly, for this research there are regional limitations, the occasion of which was unforeseen. Although the research was investigating entrepreneurship of entire Russian Federation, the majority of responses for both interviews and survey were gathered only from North and North-West regions of the country. Thus, some of obtained results may be inapplicable for the other regions.

Finally, results of the research cannot be generalized for other countries due to unique historical, political and economic backgrounds of each. Moreover, results obtained may not repeat themselves after a long-time period because of constantly changing context and stages of entrepreneurial development.

According to the mentioned aspects, the research conclusions require additional conformation by the future researches due to reduced reliability and validity.

9.3 Suggestions for Further Research

As was mentioned in the previous sections, the research has revealed several unique features of Russian entrepreneurship that require additional conformation. Therefore, one of the suggestions for a further

research is to investigate the attitudes towards unofficial activities and level of population engagement in them. That study will help to estimate development of shadow economy and more precisely investigate its effects on the entrepreneurial mindset.

9.4 Summary

The aim of this research was to investigate the impacts of shadow economy on the entrepreneurial activities and on the mindsets of entrepreneurs and non-entrepreneurs in Russia. The final goal was to estimate the prospects for entrepreneurial development for the next few years.

The study began with the introduction of the shadow economy concept, its characteristics, causes and effects on the official economy. As the research was aimed to investigate effects of shadow economy on the entrepreneurship and its development, the researcher also investigated concepts of entrepreneurship and entrepreneurial process. Chapter 4 related the unofficial economy to the entrepreneurship and regarded both aspects in the context of the Russian economy.

The empirical part of the research concentrated on the investigation of the behavioral peculiarities of active and potential entrepreneurs and their perceptions toward institutional framework and shadow economy's effects on the official economy. The final objective of the empirical research was to find differences between active entrepreneurs, individuals with entrepreneurial intentions and individuals yet not interested in entrepreneurial activity.

The last part of the research summarized the main findings and interpreted them in relation to unique historical context of the country. Finally, the prospects for entrepreneurial development were made based on gathered theoretical and empirical data.

The research revealed a positive effect of the shadow economy on entrepreneurship development and mindsets of entrepreneurs and non-

entrepreneurs. Shadow economy in combination with the little awareness of the population in legal and business issues promote formation of entrepreneurial intention through the reduction of the perceived business barriers.

Based on the empirical results, growth in entrepreneurial participation is expected within the next few years. However, growth estimated will not be fast due to the presence of institutional flaws.

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APPENDICES

APPENDIX 1. Interview

Basic questions: How long do you own and manage the enterprise? What operations are performed by your company?

1) Have you considered the possibility of large investments recently? Do you think the risk of large investments is justified?

2) Do you think that taxes (direct and indirect) applied to your business are reasonable or inflated? Is it possible to reduce them legally, through existing loopholes in the tax system? Have you resorted to tax evasion in your practice? Do you consider such possibility? Why? How high do you think is the risk of being caught and punished for the tax evasion? Do you think that punishment corresponds to a crime? Why?

3) Do you consider the existing regulations and legislation to be reasonable? Are there any that have a negative impact on your business? Do you follow all of them? How often have you noticed non-compliance of the regulations? It is possible to reduce or avoid the negative impact of the regulatory burden?

4) Have you encountered corruption (bribery) and how often? How do you feel about corruption? Could it be useful?

5) Do you and your partners always adhere to the contract terms? Or the preference is given to the informal arrangements? Why? If the contract terms are violated, will you try to get the compensation from the partner? In case of high losses, would you appeal to the court? Do you think that contracts can protect your rights and reduce the risk of loss?

6) Do you consider security of your property rights undisputable? How do you think, will you be able to uphold your property rights if necessary? What about intellectual property? How much do you believe that Russian judicial system is impartial and effective in matters of property rights?

7) Have you ever unofficially worked or labored people? Do you pay entirely official salary to your employees? Do they receive any additional monetary income? What do you think is the reason for the massive informal employment? Do you provide your employees with additional social benefits?

8) Do you consider the size of social security contributions reasonable? Considering the payments to the social security system, do you consider the level of the paid benefit to be sufficient? What do you think about prostate getting social benefits? Is it possible to avoid or reduce the payments to the social security system? Is this desirable?

9) How can you evaluate quality of public goods provided by the state? In the context of your business? How accessible are public services? Do you consider performance of the institutions to be effective? Is there any corruption within official institutions? Are paid taxes justified by the existing quality public goods?

10) How often have you met non-official agreements, services, privileges that determined obtainment of orders on a non-competitive basis? What determines the competitiveness and prosperity of a company in the market? How difficult is it to enter a new market? What barriers can be faced?

11) How difficult was to obtain finance for business establishment? Where the funds were gained? Have you ever received government subsidies?

12) What has prompted you to do business? Have the incentives changed over the time? Do you think that establishment and growth of the business has become more possible than 10 years ago?

APPENDIX 2. Survey

- 1) Specify, please, your age:
 - Less than 18
 - From 18 to 25
 - From 26 to 35
 - From 36 to 45
 - From 46 to 55
 - More than 55
- 2) Specify, please, your total work experience:
 - No work experience
 - Less than 3 years
 - From 3 to 10 years
 - From 10 to 20 years
 - More than 20 years
- 3) Specify your current employment status:
 - Unemployed
 - Officially employed
 - Part-time job
 - Multiple jobs
 - Self-employed
 - Business owner
 - Retired
 - Retired but working
- 4) Choose your main sources of income (possible to choose more than one option):
 - No personal income
 - Official salary / wage
 - Official salary / wage + extra bonus
 - Unofficial salary / wage
 - Income from own business
 - Income from self-employment
 - Additional income (e.g. from investments or additional bonuses)
 - Pension payments
- 5) Have you ever received social security payments?
 - Yes
 - No, no necessity
 - No, no willingness
- 6) Do you belong to any exemption group (students, pensioner, disabled etc.)?
 - Yes
 - No
- 7) How do you pay your income taxes?

- Pay entirely (from both official and additional income)
 - Pay partially (only from official income)
 - Do not pay taxes
 - Have no personal income
- 8) Evaluate the quality of public goods and efficiency of the institutions (judicial system, health authorities, education law enforcement system etc.):
- 1 (poor)
 - 2
 - 3
 - 4
 - 5 (perfect)
- 9) Would you like to start your own business venture in Russia?
- Yes
 - I'm already entrepreneur
 - No, that is not for me
 - No, self-employment is enough
 - No, it is too risky
 - Not sure
- 10) In which economic sector would you like to set up a business?
- Trade
 - Services (tourism, design, cafeteria etc.)
 - Construction
 - Production
 - Agriculture
 - None
- 11) Choose option(s) that you believe to be a barrier for the establishment and/or development of a business venture in Russia (possible to choose more than one option):
- High financial and time costs of establishing a business
 - Difficulties in obtaining required funds for establishment/development
 - Tax burden
 - State regulations, restricting freedom of the market
 - Weak rule of law
 - Corruption
 - Excessive competition
 - Bureaucracy
 - Lack of education
 - Other
-
- 12) Do you regard the opportunity to avoid previously mentioned barriers or to reduce their negative effects?
- No, you have to accept and obey

- Yes, but only if methods are legal
- Yes, even if methods are illegal and punishable

13) Have you or your entourage ever faced the corruption?

- Yes, in public sector
- Yes, in private sector
- Yes, corruption is ubiquitous
- No, never faced

14) Do you believe it is possible to avoid corruption while doing business in Russia?

- Yes, possible to avoid entirely
- Yes, possible to avoid partially
- Impossible to avoid

15) Read the following statements and choose to which extent you agree with each one of them:

I believe that I significantly overpay for the goods.	<input type="radio"/> Totally Agree	<input type="radio"/> More agree	<input type="radio"/> More disagree	<input type="radio"/> Totally disagree
Quality and assortment of domestic products are poorer than those of imported goods, while the price differs insignificantly.	<input type="radio"/> Totally Agree	<input type="radio"/> More agree	<input type="radio"/> More disagree	<input type="radio"/> Totally disagree
In some economic sectors, there are too many firms, whereas in other sectors companies are scarce.	<input type="radio"/> Totally Agree	<input type="radio"/> More agree	<input type="radio"/> More disagree	<input type="radio"/> Totally disagree
Most of the	<input type="radio"/> Totally Agree	<input type="radio"/> More agree	<input type="radio"/> More disagree	<input type="radio"/> Totally disagree

production companies are inherited from Soviet Union.			e	
Natural resources sector is almost entirely monopolized.	<input type="radio"/> Totally Agree	<input type="radio"/> More agree	<input type="radio"/> More disagree	<input type="radio"/> Totally disagree
Today income-generation out of rent is more preferred than through production activities.	<input type="radio"/> Totally Agree	<input type="radio"/> More agree	<input type="radio"/> More disagree	<input type="radio"/> Totally disagree
In Russia, mainly large and small businesses are present, whereas there is almost no medium-sized companies.	<input type="radio"/> Totally Agree	<input type="radio"/> More agree	<input type="radio"/> More disagree	<input type="radio"/> Totally disagree
If to exclude import, Russia is a technological backward	<input type="radio"/> Totally Agree	<input type="radio"/> More agree	<input type="radio"/> More disagree	<input type="radio"/> Totally disagree

country.				
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16) Do you believe that your property cannot be taken away by any methods?

- Yes
- No
- Not sure

17) Do you believe that most of offenders will be caught and punished impartially and according to the law, including public officials and business elite?

- Yes
- No
- Probably

18) Choose the statement that you believe to be correct:

- It is needed to invest into business development and innovations constantly in order to maximize profit in a long-term perspective.
- In terms of Russian economic environment it is needed to invest less and receive relatively smaller profit but in a shorter period.