Large numbers of shadow economy entrepreneurs in developing countries, according to new report

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There are large numbers of entrepreneurs in developing countries who aren't registering their businesses with official authorities, hampering economic growth, according to new research.

Shadow entrepreneurs are individuals who manage a business that sells legitimate goods and services but they do not register it. This means that they do not pay tax, operating in a shadow economy where business activities are performed outside the reach of government authorities. The shadow economy results in loss of tax revenue, unfair competition to registered businesses and also poor productivity – factors which hinder economic development. As these businesses are not registered it takes them beyond the reach of the law and makes shadow economy entrepreneurs vulnerable to corrupt government officials.

In a study of 68 countries, Professor Erkko Autio and Dr Kun Fu from Imperial College Business School estimated that business activities conducted by informal entrepreneurs can make up more than 80 per cent of the total economic activity in developing countries. Types of businesses include unlicensed taxicab services, roadside food stalls and small landscaping operations.

This is the first time that the number of entrepreneurs operating in the shadow economy has been estimated.

The researchers found that Indonesia has the highest rate of shadow economy entrepreneurs, with a ratio of over 130 shadow economy businesses to every business that is legally registered. After Indonesia the highest rates of shadow economy entrepreneurs are found in India, the Philippines, Pakistan, Egypt and Ghana.

In contrast, the UK exhibits the lowest rate of shadow entrepreneurship among the 68 countries surveyed, with a ratio of only one shadow economy entrepreneur to some 30 legally registered businesses.

The researchers also found that the quality of economic and political institutions has a substantial effect on entrepreneurs registering their businesses around the world.

Professor Erkko Autio, co-author of the report, at Imperial College Business School, said:

"Understanding shadow economy entrepreneurship is incredibly important for developing countries because it is a key factor affecting economic development. We found that government policies could play a big role in helping shadow economy entrepreneurs transition to the formal economy. This is important because shadow economy entrepreneurs are less likely to innovate, accumulate capital and invest in the economy, which hampers economic growth."

The researchers suggest that shadow entrepreneurs are highly sensitive to the quality of political and economic institutions. Where proper economic and political frameworks are in place, individuals are more likely to become 'formal' entrepreneurs and register their business, because doing so enables them to take advantage of laws and regulations that protect their company, such as trademarking legislation.

The researchers suggest if India improved the quality of its democratic institutions to match that of Malaysia, it could boost its rate of formal economy entrepreneurs by up to 50 per cent, while cutting the rate of entrepreneurs working in the shadow economy by up to a third. This means that the government could benefit from additional revenue such as taxes.

To create their league table, the researchers combined data from the Global Entrepreneurship Monitor (GEM) and the World Bank.

More information: Paper: link.springer.com/article/10.1 … 07/s10490-014-9381-0

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