

# SHADOW ENTREPRENEURS: AN UNEXPLORED POTENTIAL

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## ABSTRACT

An entrepreneur is a person of immense importance who is one of the vital pillars that supports economic growth of the country. A shadow entrepreneur is an individual who has not registered his business under any statutory authority. The present paper offers conceptual understanding of the term '**shadow entrepreneurs**' and impact it can exert on increasing GDP of the economy if they are brought into light. It also tries to show the impact of rising shadow entrepreneurs on the economy. The facts stated have been gathered from secondary sources. Presence of shadow entrepreneurs in the economy is leading to various deformities in the economy. These deformities are due to the assorted reasons mentioned in the paper. If this darkness is enlightened with support of government it can help to increase GDP many folds. According to a study by business today, "United States" the world's largest economy, bluster about their 28 million small business enterprises. In India the number is almost double- 'A whopping 48 million'. What keeps India lagged behind?

(Keywords: Entrepreneur, Shadow Economy, Informal Sector, Unregistered entrepreneur)

## I. INTRODUCTION

An entrepreneur is an individual who owns, organizes, and manages a business and in doing so, assumes the risk of either making a profit or losing the investment. The pivotal role which entrepreneur plays in bringing together the factor of production and making production activity possible is not unknown to anyone. Richard Cantillon(1680-1734) one of the initial economist who made attempt to explain the concept of entrepreneurship in detail considered "The entrepreneur to be a risk taker who deliberately allocates resources to exploit opportunities in order to maximise financial returns." In 21<sup>st</sup> century the definition of entrepreneur has been widened to explain how and why some individuals (teams) identify opportunities, evaluate them as valid and then decide to exploit them, whereas others don't. They steal the occasion to instigate virgin merchandise and amenities, launch new firms or new industries and create wealth. Great economist 'Joseph Schumpeter' stated that the role of entrepreneur in the economy is 'CREATIVE DESTRUCTION' that is launching innovations that simultaneously destroy old industries while ushering in new industries and approaches. For Schumpeter, entrepreneurship result in new industries and in new combination of existing input. Schumpeter's initial example was the mixture of a steam engine and current cart making new technologies to produce the horseless carriage. In this case innovation, the car was transformational but did not entail the development of dramatic new technology. It did not instantly replace the horse drawn carriage but in time, incremental improvements reduce the cost and improve the technology, leading to modern auto industry. . Two important traits that constitute an entrepreneurial spirit are: - (1) Innovation (2) risk taking. The working definition of an entrepreneur adopted, meanwhile, is somebody actively involved in starting a business or is the owner/manager of a business (Harding et al.,

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2006; Reynolds et al. 2002). India is a land of rising entrepreneurs. According to a study by business today, "United States" the world's largest economy bluster about their 28 million small business enterprises. In India the number is almost double- 'A whooping 48 million'. What keeps India lagged behind is the lack of financial resources and other establishments.

No doubt that over the period of time, there has been tremors growth of the Indian economy, there is a shadow economy which is growing at a same pace and the most important driver of shadow economy is shadow entrepreneur. The untraceable and hence untaxable entrepreneurial activities that are not reflected in a country's GDP calculation is known as shadow entrepreneurship. They keep their business records in secret account books which goes unrecorded in government's account. Though this is an illicit practice, still it is riding good in the economy. Their record goes unchecked, untraceable leading to the misplacement of government revenue. They make whacking profits but do not contribute to country's growth. Shadow economy has earned scientific attention due to its serious implications for economic performance and a deeper level of awareness about the steady growth of black-owned business start-ups, warranting the description as the "fastest mutating phenomenon" (Nwankwo et al., 2010). From last few decades, there has been raising recognition that when entrepreneurs are starting-up their ventures they may operate partly or wholly in unregistered sector (Antonopoulos and Mitra, 2009; Bureau and Fendt, 2011; Gurtoo and Williams, 2009; Hudson et al., 2012; Ram et al., 2007; Small Business Council, 2004; Webb et al., 2009, 2013, 2014; Williams 2006, 2007; Williams and Martinez, 2014a, b; Williams et al., 2012a). For every one lakh working age population, the number of formal entrepreneurs in India is 6; whereas the number of informal entrepreneurs is 764 and thus leading to loss of revenue. According to UK study, India has 2<sup>nd</sup> highest shadow entrepreneurs in the world. No one wants to deal with government.

A lot of studies have been undertaken on the formal sector entrepreneurs but there is lack of such studies on the shadow entrepreneurs. They have been neglected at all the levels whether it be academic or at governmental level. The study undertakes the task of explaining the concept of shadow entrepreneurship. This study has its own limitations. It takes into consideration only the conceptual framework but lacks empirical backing due to inability on the part of government to publish data on the informal entrepreneur.

## II. OBJECTIVES OF THE STUDY

The present paper deals with the following objectives

- To bring the concept of shadow entrepreneurs into limelight
- To show the Impact of shadow entrepreneurs on the economy
- Highlight the reasons for rising trends in shadow entrepreneurs
- Finding solution to deal with shadow entrepreneurs

## III. RESEARCH METHODOLOGY:

This research is exploratory in nature. It is based on secondary data collected from various sources like research papers, journals, articles, websites, newspapers and an informal interaction with the people who run such businesses.

## III. CONCEPT OF SHADOW ENTREPRENEUR

The concept of shadow entrepreneurs had remained in backlight even after more than 60 years of independence. A shadow entrepreneur is an individual who has not registered his business under any statutory authority. Shadow entrepreneurs are person(s) who engage in monetary transactions which goes

unreported to the government authorities who should otherwise have been reported but sell legitimate goods and services. Selling illegitimate goods and services is part of criminal activities and not related to shadow entrepreneurs in any way. According to a report, India has second largest number of shadow entrepreneur in the world. With every business that is legally registered in India there are 127 shadow businesses that are not. During the recent decades, both Western and Eastern countries face the phenomenon called shadow economy. It means that many entities transfer their activities to households and perform illegal, unregistered business.

There is assorted number of shadow entrepreneurs that we catch sight of in our day to day life but we do not pay heed to. Most familiar instance of shadow entrepreneurs are:

- Roadside food stalls
- Unlicensed taxi/cabs services
- Small landscaping operations
- Small restaurants and dhabas

These are some sorted groups of people who earn well in their businesses but they prefer to be shadow rather than a registered entity. They earn huge profits but do not pay anything to the government authority and thus are liable to tax evasion.

Shadow economy is not a new phenomenon. Although the state always attempts to define economic and juridical lines between official and non-official business, the activeness of shadow economy has always been linked with the strength of administration and standardization. The potential of shadow economy is caused by interaction of sufficient material and financial resources and demand (Misiones, 1999). Shadow economy has earned scientific attention due to its serious implications for economic performance and a deeper level of awareness about the steady growth of black-owned business start-ups, warranting the description as the “fastest mutating phenomenon” (Nwankwo et al., 2010). The informal economy is a sizeable and expanding feature of the contemporary global economy (Charmes, 2009; Jutting, de Laiglesia, 2009; Sallah, Williams, 2011; Schneider, 2007; Williams, 2010).

Researchers at Imperial College Business School have found that a large number of shadow entrepreneurs are operating in India who isn't registering their businesses with official authorities, hampering economic growth. For every one lac working age population, the number of formal entrepreneurs in India is 6; whereas the number of informal entrepreneurs is 764. This monstrous gap is leading to growth of the parallel economy.

In a study of 68 countries, Professor Erkko Autio and Dr Kun Fu from Imperial College Business School found that after Indonesia, India has the second highest rate of shadow entrepreneurs.

The below drawn table explains that number of unregistered entrepreneurs for one registered entrepreneur. The top ranked countries in the survey are

**Table 1:**

RANK	COUNTRY	SCORE
1 <sup>ST</sup>	INDONESIA	131/1
2 <sup>ND</sup>	INDIA	127/1
3 <sup>RD</sup>	PHILLIPINES	126/1
4 <sup>TH</sup>	PAKISTAN	109/1

5 <sup>TH</sup>	EGYPT	103/1
68 <sup>TH</sup>	UNITED KINGDOM	30/1

Source: adapted from times of India

While Indonesia has a ratio of 131 shadow economy businesses to every business that is legally registered, India has 127. Philippines have 126, Pakistan has 109 and Egypt has 103 shadow businesses to every legally registered business. This is the first time that the number of entrepreneurs operating in the shadow economy has been estimated.

#### IV. REASONS FOR RISING SHADOW ENTREPRENEURS

Professor Erkkko Autio and Dr Kun Fu from Imperial College Business School in one of their studies found that the number of unregistered entrepreneur is in rising trend. In 2010, Saul Estrin (shadow economy and entrepreneurial entry) found that the main reason for the rise in the number of shadow entrepreneurs is the specific cost associated with the formal entry. The shadow entrepreneurs operate in such sector because they are unable to fulfil the criteria for entry in formal sector. The cause of shadow entrepreneurship can be attributed to weak economic and financial setup. There are assorted prime movers for the rising shadow entrepreneurs

##### ❖ **Cost of entry:**

The formal entry comes up with its specific cost that may be the cost of registration or various legal formalities. There has been found a highly positive correlation of informality with cost of entry. The simulation results indicate that when entry costs into the formal and informal sectors are equalized (but there is no change in enforcement in either sector), 14.3% of previously informal firms go into the formal sector (Ulyssea,2010)

##### ❖ **Ease of business in informal sector:**

To work in informal sector (unregistered) is more privileged relative to those who remain in formal sector. The ease associated with the informal sector is the hassle free taxation and registration process. According to World Bank report 2017, India ranks 130<sup>th</sup> out of 190 countries in ease of doing business. The report is very disturbing for a country like India whose major thrust on innovation and start ups has shown no improvement in the world rankings of ease in doing business.

##### ❖ **Weak economic and financial setup:**

The economic and financial setup of a country influences the entrepreneurs for their new start-up. A country like India lacking such strong setup is the most serious hurdle leading to growth of shadow entrepreneurs. The inability to gain the access to credit facilities for the expansion and establishment of their business plans. Financial assistance has been one of the highest agenda of present government.

##### ❖ **Complexities in the registration process:**

The complexities involved in the lengthy and burdensome process of registration in the formal sector is one of the vital reasons responsible for the rise in the informal sector. The registration process involves long gestation period, favours and lobbying the officials. In El Salvador 70 percent of new business applications are rejected due to flawed or insufficient paperwork. In Kazakhstan, this figure is 65 percent. By contrast, the rejection rate is only 10 percent in Mauritius .The difference here is due to the use of standard incorporation documents. With these, entrepreneurs ensure legality without the need of notaries or lawyers. And the task at hand eases at the registry, preventing inaccuracy and boosting up processing. In 2004 the Slovak business register issued such standardized forms on its website. If the acknowledged embodiment documents are found to be

defective, companies have 15 days to rectify the errors and replenish their application without paying adds on fees. Only about a quarter of applications are returned for correction, and those are approved within two weeks. Previously, defective applications took up to six months in order to resolve in a civil court proceeding. In Jamaica one document—the articles of incorporation—is now obligatory to establish a company, after a reform in 2005. It now takes 22 fewer days to begin a business. After Estonia introduced standard documents in 2006, processing time at the registry fell from 15 days to 1. Another 65 countries have standard forms—including China, Egypt, Malaysia, Oman, South Africa, and now Bulgaria. (Simeon Djankov,2002)

❖ **Lack of knowledge and awareness about registration benefits :**

People are not aware of the benefits associated with registrations. The subsidies, low interest loans, Income and Capital Gains Tax exemptions, tax holidays for certain period and other helps as well provided by the government remains a far reaching sight for them as they are not enlightened about the same.

❖ **Social factors :**

These factors are influenced by the society. They are

1. Lack of perceptiveness of business support
2. Absence of cultural awareness.

We need to change the culture from job taker to job seeker. This itself require ages to incorporate the idea of entrepreneurship in the minds of people. Getting people out of their comfort zone is a big challenged to be faced.

**V. IMPACT OF SHADOW ENTREPRENEUR ON ECONOMY**

Shadow entrepreneur is a solitary who administer an occupation that markets statutory merchandise and services but they do not register their businesses. Since they do not file their business under any statutory body, therefore they do not pay tax, operating in a shadow economy where business activities are performed outside the reach of government authorities. The repercussion of the above said phenomena is loss of tax revenue to the government, unfair competition to registered businesses and also poor productivity - factors which hinder economic development. It should be noted that if these entities are brought into the lime light, they can surely lead to the increase in the GDP. We cannot completely forgo the importance of shadow entrepreneurs. They exert both positive and negative impacts on different section of the society such as for formal sector entrepreneurs, government and customers. Their main implication can be summarised in the following table;

**Table 2:**

<b>For informal entrepreneurs:</b>	
<b>Negative Impacts</b>	<b>Positive Impacts</b>

<ul style="list-style-type: none"> <li>• Lack of open entry to credit and financial services, partly due to narrow credit history.</li> <li>• Adversity in expanding a business which cannot be openly advertised.</li> <li>• May face higher constraints of entry to the formal sector on account of an inability to provide employment history to provide a way to their skills.</li> </ul>	<ul style="list-style-type: none"> <li>• A determinant of income to stay out of poverty.</li> <li>• Tractability in where, when and how to work (especially important for women who remain responsible for child-care).</li> <li>• Reduces constraints to entry into work because the bulk of informal work starts with close social relations.</li> </ul>
<p><b>For formal entrepreneur:</b></p>	
<ul style="list-style-type: none"> <li>• Results in an unethical competitive advantage for informal over formal entrepreneurs</li> <li>• Results in de-regulatory cultures engaging law-abiding entrepreneurs into a ‘race to the bottom’ away from administrative compliance</li> <li>• Results in ‘hyper-casualisation’ as more legitimate entrepreneurs are forced into the informal economy to compete</li> </ul>	<ul style="list-style-type: none"> <li>• Provides entrepreneurs with escape route from corrupt public sector officials</li> <li>• Provides an exit strategy in contexts where the administrative burden suppress business development</li> <li>• Enables outsourcing and sub-contracting to lower production costs</li> </ul>
<p><b>For customers:</b></p>	
<ul style="list-style-type: none"> <li>• Lack legal remedy if a poor job is done, insurance cover; guarantees in relation to the work done, and certainty that health and safety controls have been followed.</li> </ul>	<ul style="list-style-type: none"> <li>• A more economical product or service can be awarded to or asked for by customers if payment is made in cash and no voucher change hands</li> </ul>
<p><b>For governments:</b></p>	
<ul style="list-style-type: none"> <li>• Leads to loss of revenue for the government in terms of non-</li> </ul>	<ul style="list-style-type: none"> <li>• Income from informal entrepreneurs spent in the formal</li> </ul>

<p>payment of taxes owed</p> <ul style="list-style-type: none"> <li>• Minimised state’s ability to score social cohesion by decreasing the money available to governments to pursue social integration and mobility</li> <li>• Leads to a loss of administrative control over work conditions and service norms in the economy</li> <li>• Such an attempt may encourage a unconventional attitude towards the law more widely</li> </ul>	<p>economy encourages demand for formal goods and services and contributes to ‘official and registered’ economic growth.</p> <ul style="list-style-type: none"> <li>• ‘On the job’ training in informal enterprises ease pressure on the state and its agencies during times of lessened public spending.</li> <li>• Nurturing ground for the small enterprise system</li> <li>• Test-bed for neophyte businesses</li> </ul>
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Source: derived from Llanes and Barbour (2013), Williams (2006) and Williams and Nadin (2012b), Colin c Williams (2014)

Beyond this literature on entrepreneurs trading illegitimate goods and services, a further stream that feeds into this tributary is that which unravels how entrepreneurs trading licit goods and services sometimes do not declare some or all their transactions to the authorities for tax and social security purposes when they should be declared (e.g., Antonopoulos and Mitra 2009; Ram et al. 2007; Small Business Council 2004; Valenzuela 2001; Williams 2006, 2007a, b, c, 2008a, b; Williams and Round 2007, 2008; Williams et al. 2009). This literature on informal entrepreneurship has tentatively identified that many early-stage entrepreneurs and established self-employed do indeed engage in off-the-books transactions. It is not only the entrepreneurship literature however, that has started to uncover the prevalence of off-the-books practices amongst entrepreneurs,

We have seen India projecting the highest ever GDP annual growth rate of 7.3% in the last 15 years. The GDP indicates where the economy is heading. The report of NASSCOM has made clear inferences about India becoming the breeding ground for new start-ups. As per the report, India is among five largest start-ups communities of the world, youngest of all. The year 2015 ended with the number of start-ups reaching 4,200. These start-ups help in creating 80,000 new jobs and contributing immensely to the new economic growth story.

The below table shows the importance of Indian small and medium entrepreneurs for the country's economy in comparison to other country

**Table 3:**

Country	No. of SMEs	Employment	GDP Value added output	Export Share
Brunei	98%	92%	66% of GDP	-
India	95%	80% of industrial sector	40% of industrial output	35%
Malaysia	80%	17.5% of manufacturing sector	15% of total output; 17.6% of value added	15%

Pakistan	60%	80% of industrial labour force	15% of GDP	-
Philippines	99%	45%	28% of valued added in manufacturing	-
Singapore	97%	58% of manufacturing sector	41% of manufacturing output	16%
Thailand	90%	65% in industry	47% of manufacturing value added	10%
Vietnam	-	85% of labour force	65% of GDP	20%

Source: World Association for Small & Medium Enterprises, April 2004

If we take a brief look at the above table, it shows number of small and medium entrepreneurs in southeast Asian countries generating different levels of employment, GDP value added output and export share as well. A closer look at the table shows that India has 95% of the small and medium entrepreneurs generating 80% of the employment in the industrial sector and contributing to about 40% of industrial output and 35% in the export share as well.

It is very clear from the above analysis that the amount of contribution done by entrepreneurs to boost Indian economy is a huge one. Boosting them will surely increase the country's welfare. Therefore, if we bring shadow entrepreneurs into light by promoting them to get registered, it will not only increase the employment but also contribute a great deal to GDP.

## VI. POLICY IMPLICATIONS AND SUGGESTION

In the paper discussed above we have encountered with the different benefits and costs associated with the shadow entrepreneurs. If this unexplored potential is efficiently utilised there is no doubt what wonders it can do in uplifting the growth of country especially India where number of such potential is on the rise. Kirti Sharma a renowned journalist in her report suggested that in order to increase the rate of formal economy entrepreneurs by 50% developing countries like India should try to improve the quality of its democratic institutions. The important steps which can help to reduce the number of unregistered entrepreneurs and encourage them to be a part of formal sector and thus a contributing participants of the economy can be underlined in the below given points

- ✓ The government should provide sufficient financial resources in order to explore their potential and help them to convert their ideas into action in a legalised manner.
- ✓ The government must come up with the various incentives in the form of tax holidays, subsidies, concessional loans, free training to enhance their entrepreneurial skills.
- ✓ Unregistered entrepreneurs should be made fully awarded about the assorted policies run by the government in their favour for their successful implementation.
- ✓ A strong organisational setup should be constructed by government so as to deliver these services effectively.
- ✓ The policies that are launched must ensure that they sustain the program for a longer period of time. A report revealed that 40-50% of start-ups die within 5 years of inception. Therefore these flaws in the policies should be treated.
- ✓ Educational institutions need to ensure that graduates are capable of acting in an enterprising manner in the workplace either as an entrepreneur or as an intrapreneur in paid employment. This double objective can materialise through the provision of entrepreneurship education, within either a business or a technical course.
- ✓ One of the most coherent way of achieving formalisation, productive efficiency and efficient allocation of resources is to reduce cost of entry.



The government has come up with various programmes such as recently launched “Make in India Made in India”, “Skill India”, “Start up India Stand up India” - the only thing that is required is their successful implementation. Formalising informal entrepreneurship appears to be most viable policy choice (Collin C William 2014). According to a report by TOI, if government has to raise formal economy entrepreneurs by 50%, it is possible only when government is somehow able to cut shadow entrepreneur by one-third. The government policies play a big role in helping shadow entrepreneurs transition to formal entrepreneurs. This is important because shadow entrepreneurs are less likely to invest due to lack of opportunities. The government should engage honest and hard working officials in this effort so that this unexplored potential can be fully explored and thus paving up the economic growth

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