

## 1. Introduction

The informal economy is the diversified set of economic activities, enterprises, jobs, and workers that are not regulated or protected by the state. It is the part of an economy that is neither monitored nor taxed by any governmental regulation. Activities of the informal economy in contrary to the formal one, are not included in a country's gross domestic product (GDP) or gross national product (GNP). Today, the informal economy is a field of study in its own right, drawing an increasing number of scholars from multiple disciplines ranging from economics, anthropology, and industrial relations to gender studies, political science, sociology, and urban planning [1].

The informal sector constitutes a significant part of the economies in developing countries and it is very often stigmatized as unmanageable and troublesome. Nevertheless, the informal sector has provided and provides economic opportunities for the poor and has been expanding since the 1960s. For this reason, integrating the informal economy into the formal sector has become an important policy challenge. Recent scholarship on informality focuses variously on the size and composition of the informal economy, what drives or causes informality, what the consequences of informality are in terms of welfare or productivity, and what linkages exist between informality and formality, growth, poverty and inequality [1].

Albania, as a post-communist country, is facing challenges with the informal sector since its transition to a market economy. In Albania several studies were undertaken to measure the extent of informal employment, providing figures of around 30 % to 60 % of informal employment as a percentage of total employment [2]. Informality is manifested in various forms, such as unregistered businesses, undeclared workers, fiscal evasion, corruption, trafficking etc. Different researches and polls in Albania have shown that small businesses usually have expressed the concerning of competing with informal businesses in the market. Considering also other weaknesses of the SME sector, such as "limited access to finance, low degree of professionalism, difficulties in recruiting qualified personnel, absence of economies of scale" [3], informality complicates their competitiveness and sustainability in the market. Meanwhile researchers have found that through investment and innovation can be boosted the entrepreneurial performance of Albanian enterprises [4].

Through this research it is aimed to examine the relationship between informality in Albanian enterprises and their size in terms of yearly revenues, their exporting opportunities, trainings and to make a deeper analysis of

## INFORMALITY AND ENTREPRENEURIAL ECOSYSTEM IN ALBANIA

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**Abstract:** The informal sector constitutes a significant part of the economies in developing countries and it is very often stigmatized as unmanageable and troublesome. It has been a major issue for Albania since the early stages of its transition to a market economy. For this reason, integrating the informal economy into the formal sector has become an important policy challenge. The aim of this study is to examine the relationship between informality in Albanian enterprises and their size in terms of yearly revenues, exporting opportunities, trainings and to make a deeper analysis of the causes of informality and possible incentives to reduce it. The data, used for this study, are taken from the survey, implemented by the Albanian Investment Council (AIC) on tax audit, VAT reimbursement and informality during the period July-September 30, 2017. Study results reveal that main causes that lead businesses to informality are corruption and high taxes, and that there exists a significant negative relationship between the aforementioned variables. Research findings suggest that informality in the sector can be decreased by improving the ecosystem, in which Albanian enterprises operate through lowering taxes and reviewing taxation policy, training entrepreneurs and providing exporting opportunities to enlarge their market and increase revenues. This study provides distinct contributions that have theoretical implications to ecosystem researchers, as well as practical implications to policymakers and entrepreneurs.

**Keywords:** informality, enterprises, exporting, training, Albania.

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## 2. Materials and Methods

### 2.1. Main Causes of Informality and Incentives to Reduce It

Informal economy is systematically correlated with income and development. A leading cause of informal activity may be regulatory burden [5] in one cross-country study, view that oppressive regulations prevent the efforts of small entrepreneurs, in this way obligating them to stay in the shadows. A role in causing informality, play the interactions of governance with regulations [6] also stress the important role that governance plays, interacting with regulations to lower the informality. Indeed, when regulation is interacted with a governance indicator (that reflects the absence of corruption, the prevalence of the rule of law, and the level of democratic accountability), the results

indicate that regulation is positively associated to informality only for countries with governance levels beyond a certain threshold. That would lead to an understanding that for countries which have a strong governance, regulations of it are more likely to benefit the general interest, and their enforcement is likely to be higher and more even.

Another important factor is people's perspective of how well taxation is used to provide services for their benefit. In [7] it is viewed, how institutions have a significant effect in individuals' decisions whether to join the formal economy or stay informal. Particularly, they look at how the called tax morale is associated with the size of the informal sector within and across countries. Tax morale is measured using the World Values Survey's question on how justifiable people think it, to avoid paying taxes. This measure, not surprisingly, is highly correlated with regulations, corruption, etc. This measure is intriguing in light of the fact that it focuses on the part of individuals' trust in the capacity of the public sector to offer services to the public interest when they participate in the established economic and social system, against staying at the margin.

Poor institutions and inequality are at the base of a big informal sector. In [8] it was constructed a hypothetical model that informal activity is the consequence of the worker or entrepreneur's rational cost-benefit analysis, given the institutional quality, regulatory framework, and social values' system of the country, which captures the evidence that was first

put forward by [9]. This model sets up positive relationships between wealth inequality and low institutional quality, and the size of the informal sector. In their empirical examination they find enough evidence supporting the aforementioned hypothetical outcomes. Moreover, they find that the relationship between institutions and inequality is positively significant, which leads to understand that the combination of poor institutions and inequality are at the base of a wide informal sector.

If formality and informality have to do with relationship of economic activity to laws and state regulation, then the causes of informality must be searched in the nature of these regulations, relative to the structure of economic activity, and the evolution of both in relation to each other. The following factors will lead to a higher-level total amount of informality as conventionally measured: Higher proportion of low productivity enterprises, higher wage, lower optimal size of enterprise, higher private cost of regulation, lower intensity of enforcement of regulation [10]. In a study between Peru and Chile [5], concluded that law and order, regulatory freedom, and socio-demographic conditions are more advanced in Chile and, thus, contribute positively to explain the higher level of informality in Peru. Meanwhile [11] mentions mentoring and coaching programs as good incentives for business formalization.

## 2. 2. Informality and Export

Businesses, which export, have to deal with many regulations and policies of other countries too. Their controls are more often, and they have to be very careful with the laws and the informality. Also, the businesses, which export, usually tend to be larger and generate a big amount of revenue. Considering all of these, exporting businesses, which have informality as a consequence, should be fewer than non-exporting ones which have informality. One important finding is that export-oriented firms are disproportionately affected by problems, associated with customs and trade regulations [12].

In a research, conducted in China, it was done a comparative multi-case study on local entrepreneurs and returnee entrepreneurs. [13] found that "at the early stage of venturing, returnee entrepreneurs emphasized formality more than informality, while local entrepreneurs stressed informality more than formality".

## 2. 3. Informality and Business Size

Unfair competition practices are the main concern for small and medium-sized enterprises and the issue lies mainly in high informality.

What can hardly be exaggerated, is the importance of education. Education implies better and greater quality of the human capital and therefore greater ability to benefit from existing opportunities. A research, done by [14], is focusing on the education level of the largest owner of the firm, only 9 percent of the firm owners had no education at all in their sample. In their sample, the education level of firm owners was higher among the relatively larger firms. Nevertheless, the positive correlation between the firm-size and level of education of the owner was primarily due to differences in the firm-size between owners with secondary, primary or no education vs. the rest of the owners who had university degree vocational training.

## 2. 4. Informality and trainings

When mentioning training, it is clear that it comes to a positive view towards its effect in the level of informality. It

is natural to think that by training the business owners, employers etc. will give them knowledge, information and will make them aware of the circumstances and the outcomes of operating in an informal way. Different studies and researches, concerning this topic, have been made.

According to [15], the countries studied have shown forms of skills development and training, based on the principle that trainees are mentored and supported by informal sector workers. The above mentioned prove that stakeholders of the informal sector can take their futures into their own hands if they have the organizational, financial, educational and human support, needed to invest in their own skills development, and these efforts are focused more on activities and occupations that hold promise for the country's economy.

## 2. 5. Methods

The data, used in this study, are part of the survey, prepared by AIC on tax audit, VAT reimbursement and informality during the period July-September 30, 2017, where one of the researchers contributed in the data collection process. The survey was sent to approximately 8000 businesses, out of these businesses 1000 were contacted and given the information about the survey. The person, who filled the survey, had to be the owner of the company, since the survey contained a large variety of questions which the owner of the business could answer more correctly. Only 147 businesses completed the survey sent and from these businesses only 60 were useful for the research.

The variables, used for the econometric analysis, are:

1. Informality: is a dummy variable. In the question part business' owners are asked, if in case they have some informality in their business, do they have any strategy to formalize in the long term?
2. Business size: is a quantitative variable. That is determined according to the last year turnover.
3. Trainings: is a dummy variable. The question was, if the business owner had attended the training session, provided in the last years by the Tax Administration on the implementation of tax legislation.
4. Export: is a dummy variable. Businesses were asked, whether they were an exporting company.

The analysis was done using EViews 8 program. The informality question, which is a dummy variable, was the independent variable. The dependent variables are business size, trainings and exporting. To investigate relationship between the mentioned variables, an econometric analysis was performed.

## 3. Results

The biggest part of the sample (73.4 %) is composed of big businesses, which had a turnover in the last year of 8 million ALL, the medium size (15 %) had a turnover between 5 and 8 million ALL and small businesses (11.6 %) had a turnover less than 5 million ALL.

Only 23 % of the surveyed sample claimed to have attended the training sessions, while 77 % of them didn't. Meanwhile only 31.7 % of the businesses had exporting activities, while 68.3 % claimed to be non-exporting.

On the other side, 36.6 % of businesses claimed to have informality in their businesses, while 63.4 % claimed that they didn't have any informality. In the above percentages regarding the business size, 73.4 % of businesses were big businesses, which is near the percentage of businesses not having informality.

From the businesses, claiming to have informality, 41 % of them were from the wholesale and retail sector, 27 % services sector, 18 % manufacturing sector and 14 % transportation and storage sector.

46 % of businesses that have claimed to have informality are big businesses, 27 % medium businesses and 27 % small businesses. In comparison to the general frequency percentage it is observed a decrease of percentage of big businesses and an increase in the percentage of medium and small ones. This may also be an indicator that the greater business size means the probability to have informality is less.

From businesses that claimed to have informality only 13.6 % of them had attended training sessions, while 86.4 % hadn't attended. In comparison to the general frequency percentage, we observe a decrease of approximately 10 % in the ones that had attended trainings and an increase of the same percentage in the ones who hadn't. This again is an indicator of the opposite relationship between trainings and informality.

Only 9 % of the businesses, claiming informality, are exporting, while 91 % are non-exporting ones. If we compare the results with the ones in the general characteristics part, we observe a decrease of more than 20 % in exporting businesses and an increase of the same in the non-exporting businesses. This may be indicator of the opposite relationship between informality and exporting. It may be a good indicator that if the business is an exporting business, the probability for this business to have informality is low.

When businesses were asked to give their opinion about causes that lead to informality in the first open question, 36 % of them claimed corruption, 12 % government regulations, 30 % high taxes, 12 % non-professional administration, 3 % lack of information and 5 % non-favorable business climate. On the other side, 41 % of businesses proposed lower taxes, 18 % a friendlier approach, 13 % more professionalism from the taxation administration, 23 % review of taxation politics and 5 % proposed for simpler procedures. As it can be observed, the most repeated incentive has to do with taxations.

At the relationship part between informality, business size, training and exporting, an econometric analysis and the needed tests were conducted. The result is that there is a strong significant relationship between informality and business size even at 99 % confidence level, between informality and exporting at 95 % confidence level and between informality and trainings at 90 % confidence level. All the mentioned variables have a negative relationship with informality. This means the greater revenue the smaller the probability of that business to have informality, and if the

business is exporting and business owner has participated in training, again the probability for these businesses to have informality is lower.

#### 4. Discussion

Informality is one of the main concerns regarding Albanian businesses. It remains a challenge for the Albanian government and throughout the years there have been taken different actions, trying to reduce it. There are lots of issues, which cause informality, and informality in businesses may be related to some characteristics of them. The aim of this paper was to examine the relationship between informality in businesses in Albania, business size in term of the last year's revenue, trainings, if the business owner had participated or not and exporting, if business was an exporting one or not. Also, there was done a further examination of businesses, which claimed to have informality and their suggestions regarding the factors which cause informality and possible incentives to reduce it.

Based on previous researchers, mentioned in the study background, the main causes of informality were oppressive regulations which prevent the efforts of small entrepreneurs, obligating them to stay in the shadow, and taxation and people's view toward its usefulness for their benefit. Interactions of governance with regulations play also a role in causing informality. Also, the taxation part, which was highly correlated with the rule of law and corruption, makes some businesses choose the informality part due to the high taxes they have to pay. Main concerns of Albanian businesses had to do mainly with these causes. When they were asked about their opinion regarding the main causes that encourage informality, the answers with the highest frequency percentage were high taxes and corruption respectively 30 % and 36 %.

According to [5], informality decreases when law and order, business regulatory freedom, or schooling achievement rise. Also, [11] mentions mentoring and coaching programs as good incentives for business formalization. When Albanian businesses were asked to propose incentives to lower informality 41 % of the answers were to lower taxes and 23 % – to review of taxation politics. Also considering the fact that very few businesses had attended trainings, it would be a good step maybe to increase the number of participants in those trainings. Furthermore, it may be a good idea to start giving more attention to the answers and ideas, given by the business owners, since the causes and incentives are almost complementary to each other. In this way an increase in business regulatory freedom would lead to a better business climate and as a result a decrease in informality.

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