



# SELF-EMPLOYMENT, MICRO AND SMALL BUSINESS IN ARMENIA

EMERGING CULTURE OF ENTREPRENEURSHIP

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# Introduction

## About the study

The breakdown of the Soviet Union and the creation of a market economy on the institutional structure of a planned economy has been a unique phenomenon. The magnitude of the social, economic, political and institutional transformation is unprecedented. Small scale entrepreneurs are new and important actors in the post-Soviet space. Generally, small scale entrepreneurship occupies a wide spectrum from urban informal self-employment or private small-scale farming to established and registered firms, which, according to the methodology of the National Statistical Service of Armenia, are considered to be ‘micro-business’ if they have up to 10 employees, while a staff number of up to 50 will put them in the ‘small business’ category, which, taking into consideration the size of the Armenian labor market, may also be considered medium size.

Empirical evidence of the state of affairs of Armenian small entrepreneurship sector is very rare and insufficient to have a clear understanding of the phenomena of small and micro entrepreneurship in Armenia. Some data can be collected from the Tax Service website, providing fragmentary data. Although it includes the whole enterprise population, the amount of published data is very limited and can provide us only with basic numerical variables, while sociological issues such as motivation, readiness to risk, to invest, self-esteem, problem solving skills and others – remain outside of the picture. Moreover, the state agencies are able to register only formal enterprises, formal workers, or formal parts of enterprises – not the cases when enterprises hide parts of their income, employees, or turnover from the state agencies.

The objective of this research is to fill this existing gap. It aims to assess and evaluate Armenia’s small and micro entrepreneurship, its financial state of affairs and the quality of the regulatory environment in which the business operates - Armenia’s business culture, which is an important component for the success of emerging business. Main source for the study is the data gathered from a survey which was conducted within this project with 600 entrepreneurs and self-employed. In addition to the survey data, the external sources were used to bring the data into the context, strengthen argumentation and add international comparisons to the study.

## Acknowledgements

The research is conducted within the same framework as the study “Emergence and Evolution of Entrepreneurship in Georgia,” which also examined small post-Soviet economy in transition through the survey data. The project is coordinated by Philippe Rudaz, who was also an initiator of the project as an extension of the existing methods and approaches to the Armenian case. The supervisor of the project is Prof. Paul Dembinski. It is part of the Academic Swiss Caucasus Net project, coordinated by Denis Dafflon and directed by Prof.

Nicolas Hayoz hosted at the University of Fribourg and financed by the Gebert Rűf Foundation in Switzerland.

## Methodology

**The fieldwork** for the survey on the “Emergence and Evolution of Entrepreneurship in Armenia” was conducted in April 2016 in Armenia (Yerevan and Lori Province). In Yerevan, 420 face to face interviews were planned, in Lori province, 180 face to face interviews were planned; the total number of interviews at the end of the fieldwork slightly exceeded the planned number and reached 606. Overall, 105 self-employed, 45 micro business and 30 small business representatives were reached. The list of taxpayers issued by the State Revenue Committee of Armenia was used as a sampling frame. The list was filtered and 600 names were randomly selected and the reserve list consisting of 1800 names was created to fill the gap in case of low response rate.

There still are some **limitations of the study**. In some cases, especially regarding the size of the income, entrepreneurs could be either dishonest or avoid answering, which could lead to a shift in the overall results. At the same time, despite the fact that the number of surveyed individuals is rather large, it might be still insufficient to be fully representative, especially regarding small enterprise. The fact that fieldwork was conducted in two out of ten provinces of Armenia is also a limitation; in addition, it was conducted primarily in urban places, while rural areas, accounting for more than  $\frac{1}{3}$  of Armenia’s population were excluded from the study, since most of activities there are unregistered. Another limitation is the low number of self-employed in agriculture included in the list, since most of farmers do not pay taxes except the cases when they proceed food or hire people outside of their household so they were few in the State Revenue Committee’s taxpayers list.

The following **definitions** were used for the purposes of this research:

- ❖ “*Entrepreneurship*” is defined here as a process from intention to action that may lead to the creation of an enterprise, both formal and informal.
- ❖ *Self-employed* – a person, who generates income through his/her self-employment, or works for free in family enterprise for family benefits.
- ❖ *Micro enterprise* – a legal form of enterprise with number of employees less than 10 people, including Physical entities registered as taxpayers.
- ❖ *Small enterprise* – a legal form of enterprise, where the number of employees does not exceed 50 people.

Two different **questionnaires** were implemented, one for the small business representatives and the other for small business representatives and self-employed people, each including about 90 questions. The questionnaires were divided into several blocks:

- ❖ General information and the history of the enterprise;
- ❖ Motivation of doing business;
- ❖ The influence of formal and informal institutions over the entrepreneurial activities;
- ❖ Non-material and material resources and opportunities;

- ❖ Informal institutions attitudes toward the entrepreneurship;
- ❖ Level of knowledge and information;
- ❖ Perception of opportunities and financial situation.

## Emergence of entrepreneurship in Armenia: difficulties of transition

Entrepreneurship is being developed in post-Soviet Armenia for 30 years so far. While before Perestroika any private entrepreneurial activity was prohibited in the Soviet Union, in late 1986, the law on “Individual labor activity” was adopted. In 1987, a new law on “Cooperatives” was introduced, which allowed certain level of private economic activity on experimental basis. It was further enhanced in 1988 to allow new form of enterprises to have higher income legally.<sup>1</sup>

For the first time, the Soviet Government allowed individuals to own small private businesses and to hire and fire workers only in August 1990.<sup>2</sup> Since Armenia gained independence in late 1991, there have been no legal limitations on business activity. However, nowadays entrepreneurship still faces difficulties and lack of initiative and the legal framework is not the biggest issue here.

Private entrepreneurship in Armenia was born from the Soviet parallel market that was built on private initiative, but was illegal for decades. Its size was estimated to be around 12% of NMP<sup>3</sup> in 1965, 18% in 1980 and 21% by 1989.<sup>4</sup> After the collapse of the Soviet Union, the share of the shadow economy increased, exceeding 60% of GDP in 1995-1996.<sup>5</sup> The growth of the shadow economy was accompanied by the process of primitive capital accumulation and monopolization of many of business markets in Armenia.<sup>6</sup> Oligarchs, insiders and high-level state sector workers were projected to become the primary beneficiaries of the initial stage of the post-Soviet reforms, while the new entrants to the market were expected to become winners at the next stage.<sup>7</sup> However, the time needed for the reforms to bring substantial effect was underestimated and in most cases, reforms were partial.<sup>8</sup>

The transition was accompanied by a sharp decline in the economy as well as a change in its structure. While the Soviet economy was characterized by a huge and not very efficient industrial sector with large volumes of capital investments and construction, in the post-Soviet period the services sector and trade grew. A large number of people were left unemployed; in return the share of agriculture increased, since it is less dependent on foreign markets and less vulnerable to political shocks. While Armenia can restore its pre-transition

<sup>1</sup> David A Duker, *Restructuring the Soviet Economy*, London and New York: 1992, pp. 95-98.

<sup>2</sup> Joint Economic Committee – US Congress, *Former Soviet Union in Transition*, Washington: 1993, p.277.

<sup>3</sup> NMP (Net Material Product) – core indicator of the Soviet system of National accounts. It included mostly material production and excluded most of services. In 1989, NMP consisted 71% of Armenia’s GDP

<sup>4</sup> Kim, Y. B. and Y. Shida. 2014. Shortages and the Informal Economy in the Soviet Republics: 1965-1989. The Institute of Economic Research, Hitotsubashi University, RRC Working Paper Series No. 43: 28.

<sup>5</sup> UNDP. 2001. 10 Years of Independence and Transition in Armenia. National Human Development Report.

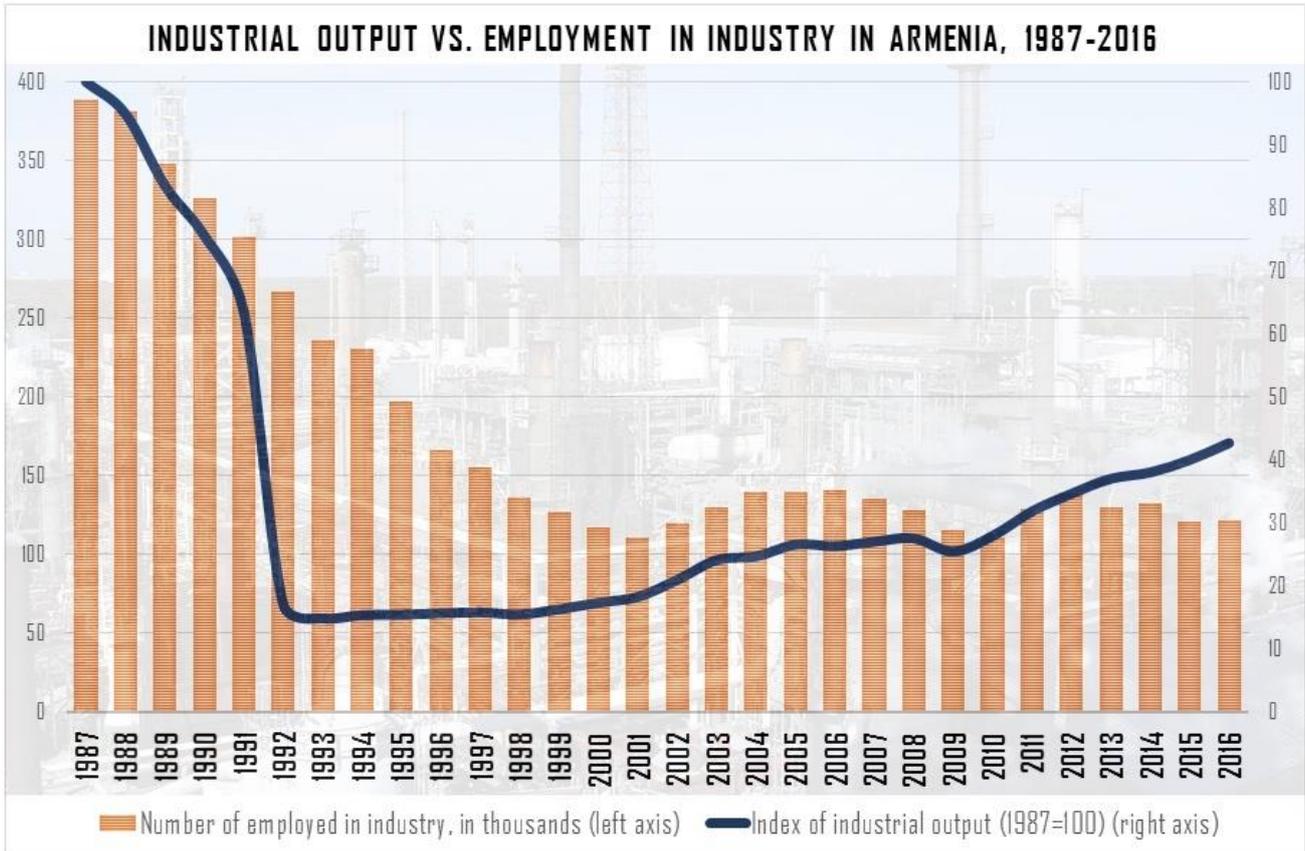
<sup>6</sup> Mikaelian, Hrant. 2016. *Shadow Economy of Armenia* (in Rus)

<sup>7</sup> World Bank. *Transition. The First Ten Years. Analysis and Lessons for Eastern Europe and the Former Soviet Union*. Washington: 2002, p. xxii

<sup>8</sup> Joel S. Hellman, “The National Council for Soviet and East European Research,” Washington, 1997. <https://www.ucis.pitt.edu/nceer/1997-811-01-Hellman.pdf>

GDP by 2020, in industry it has not reached even half of it and even in the best-case scenario the gross industrial output will reach the pre-transition peak only by 2027-2030. The dynamics of industrial production and employment in industry are presented in the chart below.

Figure 1. Armenia's industry in transition



Source: official Armenian and Soviet data and recalculation for the period of 1992-1997, for which the data is very inaccurate

Difficulties during the early stages of economic transition lead to public disappointment by the market economy and the Soviet propaganda clichés which regarded business as “speculation” revived within the Soviet society.<sup>9</sup> Trust in market economy has decreased in parallel with growth of Soviet nostalgia. Gallup 2013 survey showed that 66% of Armenia’s residents see more harm from the breakup of the Soviet Union.<sup>10</sup> EBRD’s Life in Transition Survey showed a vast decrease of a preference for a market economy system during the last decade.

Table 1. Dynamics in market economy preference, Armenia and beyond

	Market economy	Planned economy	Difference
Armenia (2010)	50%	18%	+32%

<sup>9</sup> Rutgaizer, Valery. 1992. “The Shadow Economy in the USSR.” Berkeley Duke Occasional Papers on The Second Economy in the USSR, Paper #34.

<sup>10</sup> Nelli Esipova and Julie Ray. Former Soviet Countries See More Harm from Breakup. Gallup, 19 Dec. 2013. <http://news.gallup.com/poll/166538/former-soviet-countries-harm-breakup.aspx>

Armenia (2016)	36%	22%	+14%
Georgia (2016)	34%	20%	+14%
Azerbaijan (2016)	16%	18%	-2%
Transition region (2016)	35%	36%	-1%
Western Europe (2016)	64%	18%	+46%

Source: LiTS III<sup>11</sup>

The shift in public opinion affects both public trust in successful reforms and private initiative. In Armenia, both are at low levels. For instance, in 2015, satisfaction with the National Assembly's work was as low as 14%, while 77% were dissatisfied its work.<sup>12</sup>

According to the II wave of Life in Transition Survey, only 8% of those surveyed in Armenia ever tried to set up a business, with around half of them being successful. Overall, by 2010, only 4% of Armenia's residents have set up successful businesses.<sup>13</sup> Both shares of those who ever tried and succeeded were the lowest in the Transition region.<sup>14</sup> One of the possible explanations could be high deviation in this particular case – of other statistical artefact. However, this explanation does not seem to be credible enough. Even Azerbaijan, where two thirds of those who tried to start a business have failed, had slightly higher share of successful businesspeople and by 50% higher share of those who has ever tried.<sup>15</sup>

In Armenia, less than half of respondents mentioned lack of capital as a primary reason for failing to run successful business, around 15% mentioned insufficient bureaucracy and bribes, and virtually no one mentioned threatening from the competitors. All of the aforementioned problems for emerging businesses were common for the whole region and did not specify Armenia as especially poor or as an over-bureaucratized society among the transition region. So, the following reasons could explain the lack of initiative in Armenia:

- ❖ Extractive institutions favoring the few,
- ❖ Widespread paternalist approach,
- ❖ Skepticism towards the market economy,
- ❖ Low financial literacy,
- ❖ Fuzzy definition of the term “business”.

Most probably, all of the aforementioned had their influence over the final result. We've already seen that the preference for a market economy is rather low in Armenia, at around just 1/3 of population. Legal business framework has improved lately and now Armenia is 38<sup>th</sup> in the “Doing Business 2017” ranking, indicating reforms in regulatory environment.<sup>16</sup>

<sup>11</sup> “Life in Transition. A decade of measuring transition”, EBRD, pp. 76-95.

<http://www.ebrd.com/documents/oce/pdf-life-in-transition-iii.pdf>

<sup>12</sup> Public Opinion on RA Constitutional Reforms, APR Group report, 11 Dec 2015, p.14.

[http://www.aprgroup.org/images/Library/Constitution/report\\_on\\_ra\\_constitutional\\_reforms\\_2015\\_eng\\_q.pdf](http://www.aprgroup.org/images/Library/Constitution/report_on_ra_constitutional_reforms_2015_eng_q.pdf)

<sup>13</sup> Note: regional averages for both are much higher: 13% and 8% respectively

<sup>14</sup> EBRD Transition Report 2011, pp. 76-80

<sup>15</sup> Ibid

<sup>16</sup> “Doing Business 2017. Equal Opportunity for All.” World Bank Group Report.

<http://www.doingbusiness.org/~media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB17-Report.pdf>

However, the legal side is not the biggest concern, while many institutions still have informal subversive core and favor insiders over new entrants in Armenia.<sup>17</sup> According to the Worldwide Government Indicators, Rule of law in Armenia is estimated at 50 percentile rank, i.e. average in the world.<sup>18</sup>

CRRC Polls revealed the existence of paternalist approaches. Initially, paternalism has been specific to the traditional culture and has become core of the state-society relations during the Soviet period of history. Nowadays, thanks to semi-authoritarian political system, economic crisis of late 2000s and the declared “social state,”<sup>19</sup> paternalist approach even increased during the last decade in Armenia. It’s almost as widespread as in Azerbaijan and significantly deeper-rooted than in Georgia.

**Table 2. Government’s role according to the residents of the Caucasus countries (share of answers)**

	Armenia (2008)	Armenia (2010)	Armenia (2011)	Armenia (2013)	Armenia (2015)	Azerbaijan (2011)	Georgia (2011)	Georgia (2015)
Government as parent	68	70	73	71	72	75	54	48
Government as employee	28	27	18	22	21	17	35	41
DK/RA	4	4	9	7	7	8	11	11

Note: The question text was “Please tell me which of the following statements you agree with? 1. People are like children; the government should take care of them like a parent 2. Government is like an employee; the people should be the bosses who control the government”

Sources: DI 2008<sup>20</sup>, CB 2010<sup>21</sup>, CB 2011<sup>22</sup>, CB 2013<sup>23</sup>, CB 2015<sup>24</sup>

Financial literacy in Armenia is on a very low level even by regional standards. According to the S&P Global FinLit Survey that was conducted in 2015, less than 20% of Armenia’s residents were financially literate, compared to 30% in Georgia and 36% in

<sup>17</sup> See Iskandaryan, Mikaelian, Minasyan, War, Business and Politics. Informal Networks and Formal Institutions in Armenia, Yerevan: 2016.

<sup>18</sup> World Bank Worldwide Governance Indicators, 1996-2016.

<http://info.worldbank.org/governance/wgi/index.aspx>

<sup>19</sup> According to Article 1 of its Constitution, Armenia was described as a “sovereign, democratic, social state.”

<http://www.parliament.am/legislation.php?sel=show&ID=5805&lang=eng>

<sup>20</sup> CRRC Data Initiative 2008 Armenia dataset, ODA.

<http://caucasusbarometer.org/en/cb2008am/codebook/>

<sup>21</sup> CRRC Caucasus Barometer 2010 Armenia dataset, ODA.

<http://caucasusbarometer.org/en/cb2010am/codebook/>

<sup>22</sup> CRRC Caucasus Barometer 2011, cross-country regional dataset, ODA.

<http://caucasusbarometer.org/en/cb2011/codebook/>

<sup>23</sup> CRRC Caucasus Barometer 2013, Armenia dataset, ODA.

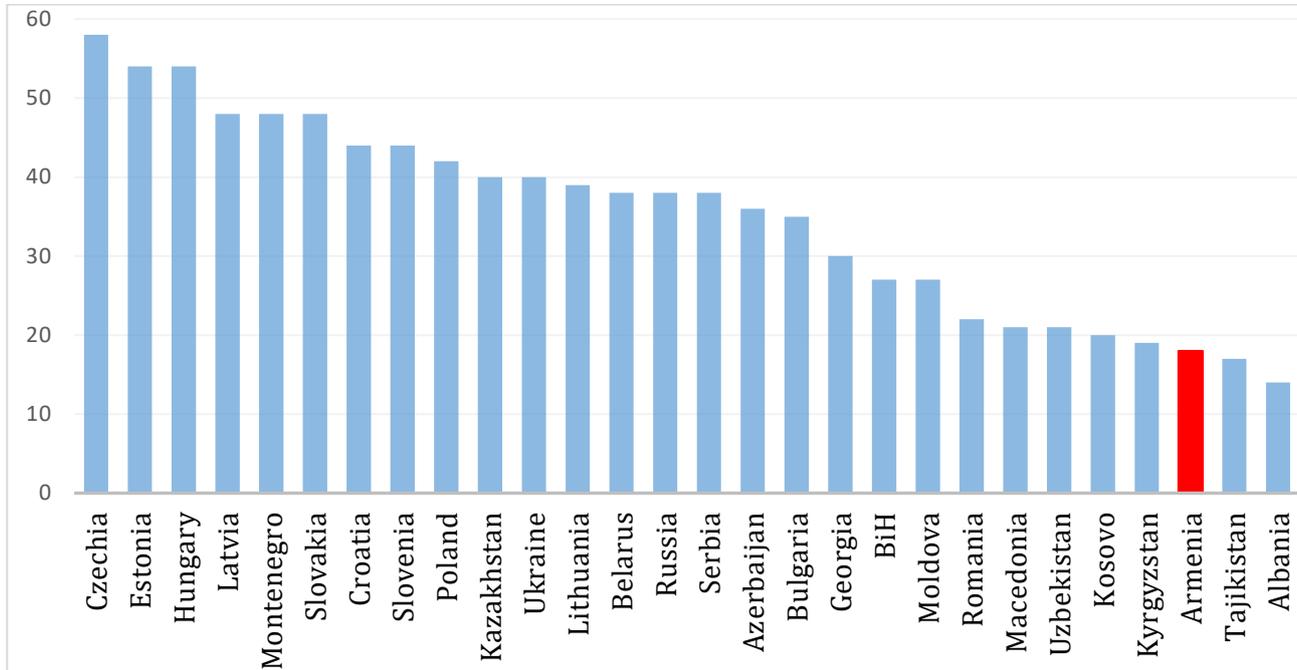
<http://caucasusbarometer.org/en/cb2013am/codebook/>

<sup>24</sup> CRRC Caucasus Barometer 2015, cross-country regional dataset, ODA.

<http://caucasusbarometer.org/en/cb2015/codebook/> Note: in 2015 survey was held only in Armenia and Georgia

Azerbaijan.<sup>25</sup> Low level of financial literacy undoubtedly affects people’s possible success and even readiness to take risks and should be considered one of the primary reasons of low entrepreneurial activity in the country.

**Figure 2. Level of financial literacy across the former Socialist countries (2012)**



Source: Klapper, Kusardu, van Oudheusden<sup>26</sup>

Another reason for the low indicators of business initiative in the country could be fuzziness of the definition of “business.” According to our survey, many small and micro entrepreneurs do not mark their economic activity as “business” and do not consider themselves as “businessmen.” One of the reasons for that could be the instability of their economic activity and income. Since there are currently around 80,000 active small and micro tax payers,<sup>27</sup> many of which have more than one owner, the number of 3.7% of successful businesspersons in Armenia seems to be either outdated or underestimated. SMEs turnover was equal to 32% of GDP in 2015 and 36% of GDP in 2016. SMEs have paid 35.8% of all taxes in 2015 and 36.5% - in 2016<sup>28</sup>.

These hypotheses will be tested by the survey which was conducted by the CRRC within the framework of the research.

<sup>25</sup> Financial literacy was defined as correct answer on four out of five basic questions on risk diversification, inflation, interest and compound interest.

<sup>26</sup> Leora Klapper, Annamaria Lusardi, Peter van Oudheusden, Financial Literacy Around the World. Insights from the Standard & Poor’s ratings services Global Financial Literacy Survey <http://gflec.org/initiatives/sp-global-finlit-survey/>

<sup>27</sup> Artak Manukyan, “SME situation in Armenia,” National Center of Public Policy Research (in Armenian). <https://www.slideshare.net/Artako/sme-situation-in-armenia-author-artak-manukyan>

<sup>28</sup> Data on taxes paid, number of employees, number of active taxpayers and the turnover of SMEs is available on the website of the Ministry of Economic Development and Investments of the Rep. of Armenia. <http://mineconomy.am/hy/449>

# The portrait of a small entrepreneur in Armenia

## Demographics

The study of the demography of small entrepreneurs and self-employed in Armenia reveals several interesting features. While the demographic structure of the self-employed and microbusiness representatives in Armenia is similar to the demographic structure of the social groups relevant to them (the urban population of Yerevan and Lori), in the small business sector there are quite noticeable differences compared to the whole population.

The overall number of men and women included in both datasets combined was equal. However, there were differences considering the size of the enterprises and region of their location. Among small businesses, males were in the majority (about 57% of respondents), while among micro businesses and self-employed, there were more females (52%). Males were more present in Yerevan, while females in Lori. Notably, Lori province is characterized by relatively high levels of equality on the local self-governance level compared to other Armenian provinces.<sup>29</sup> Apart from the local cultural peculiarities, there is another reason for that – mass labor migration of males left several villages completely without men and deformed the age and sex structure of the population of the region.<sup>30</sup>

Interestingly enough, the average age of women involved in small business is significantly lower than that of the self-employed and women involved in microbusiness. According to our hypothesis, the age and sex structure of the self-employed and microbusiness representatives is quite close to the structure of general population in the respective regions. For the same reason, the average age of local female politicians was higher than that of males: women needed to acquire more social capital to be able to get involved in politics.<sup>31</sup> Another reason is that female life expectancy in Armenia exceeds that of men by 6.5 years.<sup>32</sup>

However, the average age of women in the small business dataset appeared to be lower than the average age of men. This fact requires additional explanations. Most likely the explanation would have the technical nature: in some cases, the respondent was not the owner him(her)self. The engagement of young, educated women in top managerial positions in the small firms is rather high, so that could explain the shift in the age and sex structure of the small business representatives.

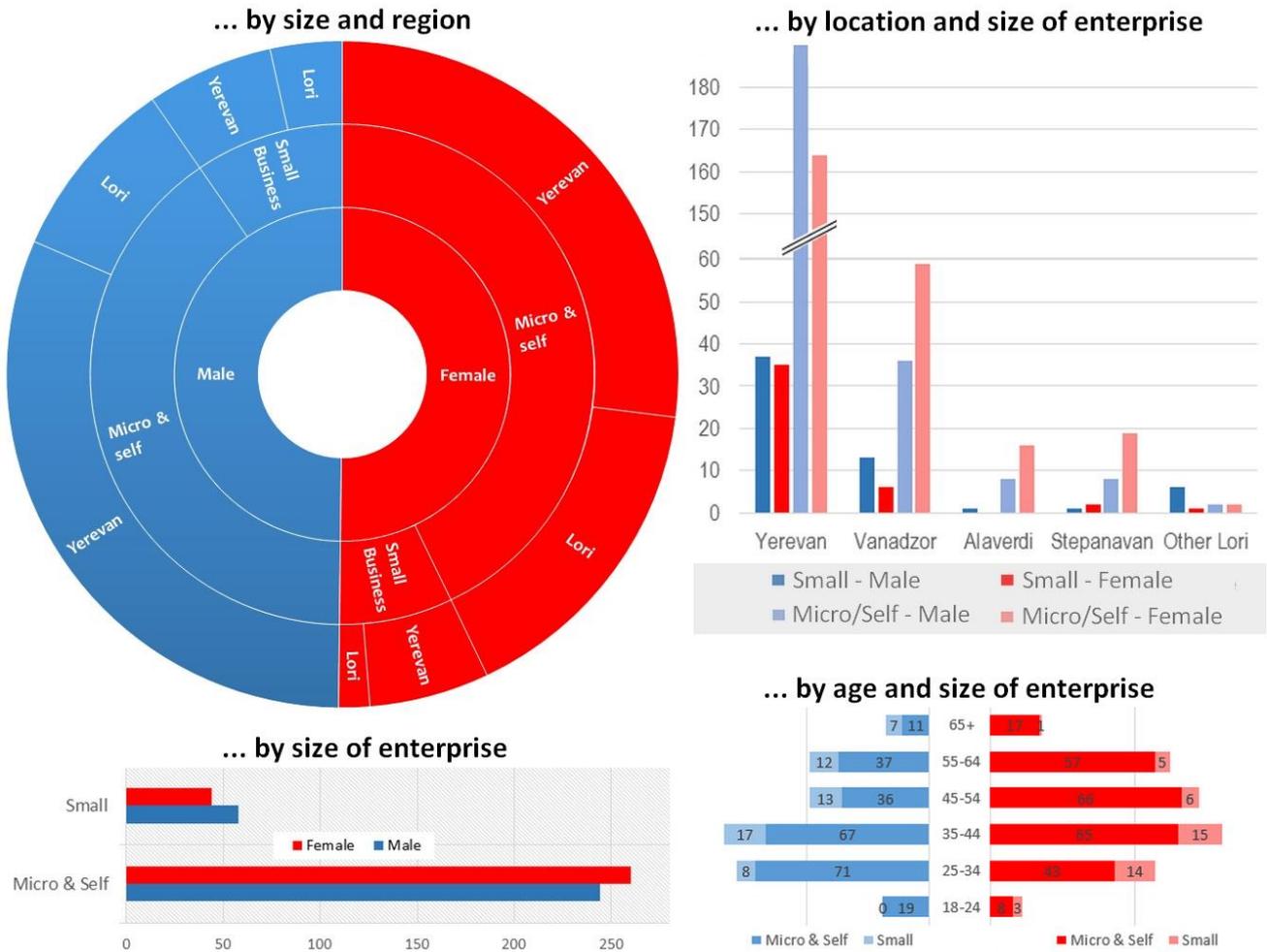
**Figure 3. Sex distribution of respondents by age, region, locality and size of enterprise**

<sup>29</sup> [http://www.armstat.am/file/article/kanajq\\_ev\\_txamardik.pdf](http://www.armstat.am/file/article/kanajq_ev_txamardik.pdf) pp. 156-158

<sup>30</sup> <http://www.bbc.com/news/world-europe-14386472>

<sup>31</sup> [http://c-i.am/wp-content/uploads/2012-Women-in-local-administration\\_eng.pdf](http://c-i.am/wp-content/uploads/2012-Women-in-local-administration_eng.pdf)

<sup>32</sup> [http://www.armstat.am/file/article/demog\\_2016\\_5.pdf](http://www.armstat.am/file/article/demog_2016_5.pdf) p.93



As one could expect, parenthood affected women’s business activity in small business, but had a very small impact on their activity in micro business and self-employment. Partly it could be explained by the relatively young age of women, involved in the small business, but the most accurate explanation would be that businesswomen still have to choose between family and career. At the same time, there was no connection between the number of children and size of business among men; the number match the population average.

As mentioned, the number of children of women involved in micro business and the self-employed virtually matched the number of children among the corresponding population group, with the discrepancy being within the error margin. This proves our hypothesis that the micro business representatives and the self-employed are not a separate group in the population. Thus, the preliminary conclusion would be that running a micro business is, in most cases, a form of employment rather than business activity.<sup>33</sup>

**Table 3. Selected demographic characteristics of the surveyed businesspersons and self-employed**

	Small business	Self-employment/micro business
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<sup>33</sup> For instance, according to the 2011 national population census, mean number of surviving children by women residing in urban area, aged 25-59, is 1.735 per woman, very close to the results in our sample of self-employed and micro businesses.

	Mean age	N of children	Mean age	N of children
Male	48.4	1.97	40.9	1.68
Female	38.8	1.27	46.2	1.71

## Education

Most of the respondents in both groups combined had received higher education – 56%; 23% had general education and 21% a professional one. The number of people with university degree among businesspeople is twice as high as among general population.<sup>34</sup> The variation based on the size of business is high: 83% of surveyed small business representatives have university degree compared to just 50% of micro business representatives and the self-employed. Males are more likely to have attained higher education than females: 61% vs 51%.

The data on the educational profile of micro business representatives show that that the number of people with the university degree was higher among them compared to the general population. E.g., among the urban population of Armenia, 32% of those aged 20 and more had a university degree, according to the 2011 population census. Narrowing this group to 25-49, the most relevant for business, would increase their number to 35%.<sup>35</sup> In Yerevan, where most of respondents came from, the numbers were higher: 40% and 46% respectively.<sup>36</sup> Scaling down to the employed population would again increase these percentages. Since 50% of the self-employed and micro business representatives had a university degree, we can assume that the education level of micro business and the self-employed was very close to the indicators of the corresponding demographic groups. Thus, this is another confirmation that in this case we do not deal with a separate social group, as in the case of small business representatives.

**Figure 4. Educational profile of business owners, by sex and size of business**

<sup>34</sup> According to the 2011 Population Census, which was held in 2011, 21.7% of people aged 14 and older had higher education, 20.4% had technical education and 55.6% - secondary and lower.

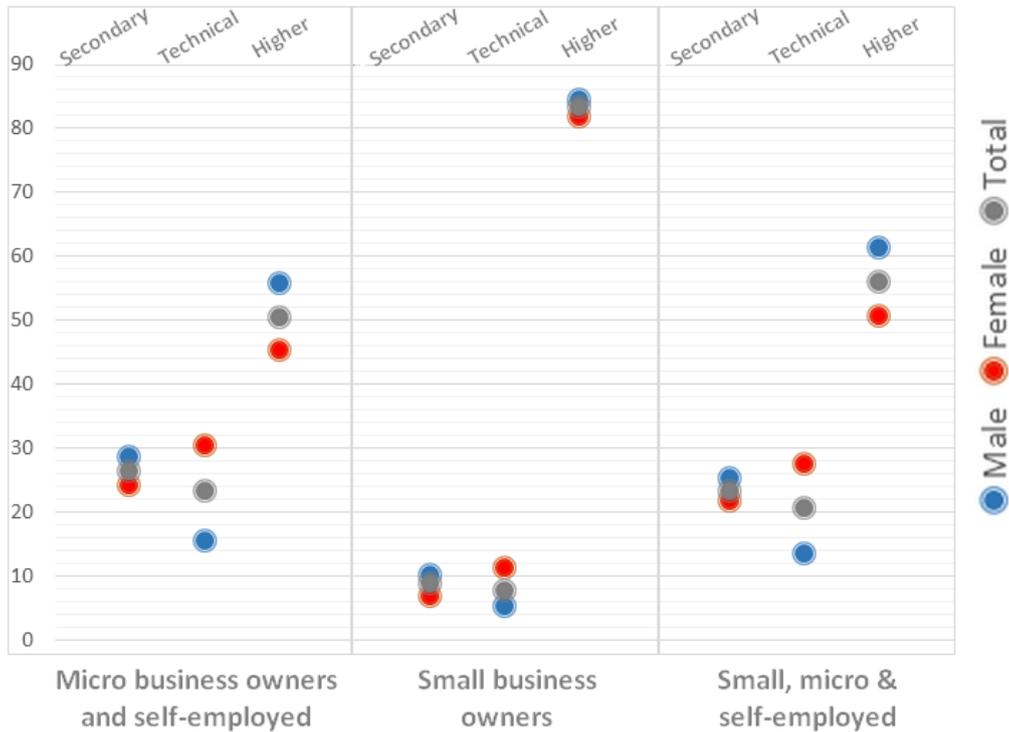
According to the CRRC Caucasus Barometer 2015, 27% of Armenian adults' education level was higher than secondary, 28% - secondary technical and 44% had secondary or lower education.

<http://caucasusbarometer.org/en/cb2015am/RESPEDU/>

Most of the difference can be explained by the difference between age groups surveyed – aged 15 and older by the census, 18 and older – by the survey. Another reason is fast growing of enrollment in higher education

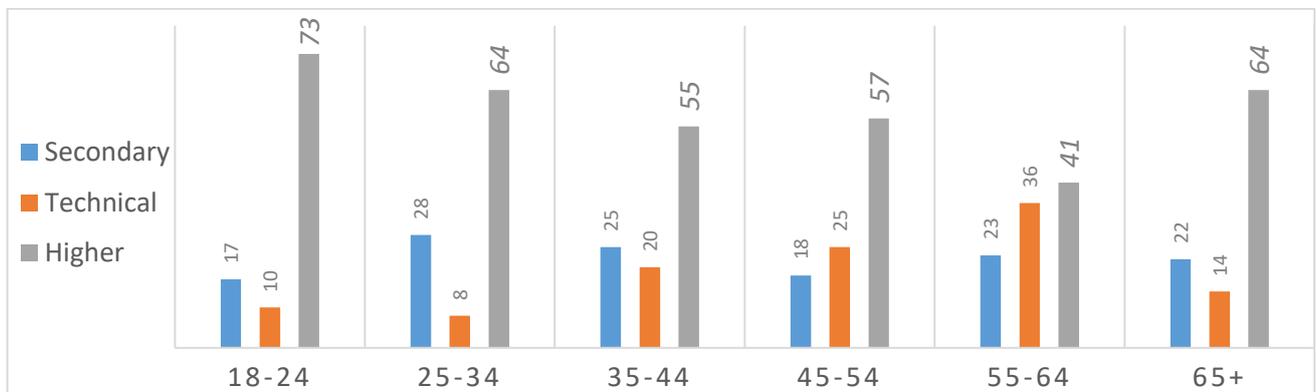
<sup>35</sup> 2011 Population Census national results. Population (rural, urban) Distribution by Educational Attainment, Scientific Degree, Sex and Age. <http://www.armstat.am/file/doc/99486173.pdf>

<sup>36</sup> 2011 Population Census results in Yerevan. Population (rural, urban) Distribution by Educational Attainment, Scientific Degree, Sex and Age (in Armenia). <http://www.armstat.am/file/doc/99483658.pdf>



There is a pronounced pattern: younger entrepreneurs are more likely to have achieved a higher education level. 73% of the entrepreneurs and the self-employed aged from 18 to 24 have a university degree compared to just 41% among the group aged 55 to 64. This corresponds to the national trends as well: the share of those having university degree decreases with age. The group of people aged 65 years and over stands alone in our sample; it does not match the above-mentioned trend. The most credible explanation for this phenomenon would be that this group is comprised of businesspeople who had big experience and could be involved in the business perhaps since the late 1980s or 1990s, when the threshold for entry into business was much higher than now.

Figure 5. Educational profile of business representatives, by age



However, if not focusing on the formal criterion of education, then the most relevant question would be whether people involved in entrepreneurial activity had any education relevant to business or if they had at least passed any appropriate training course in business

or management. 32.4% of small business representatives have passed such training, while 67.6% had no such experience. At the same time, just 13.7% of micro business representatives and the self-employed have either formal or informal training in business or management.

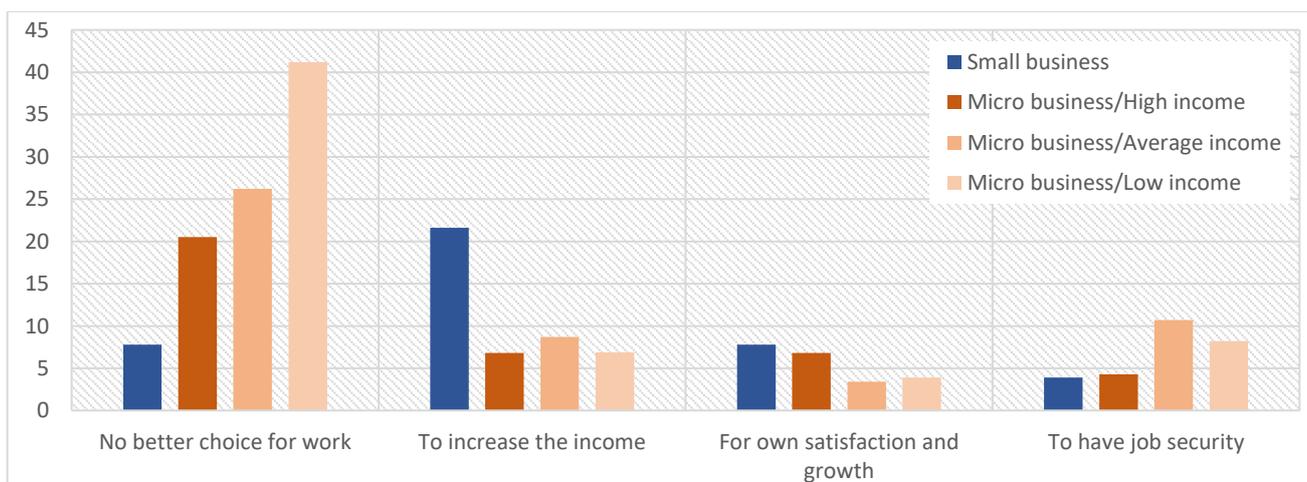
Such courses are important as a recipe for success, although not all entrepreneurs believe so. 29.4% of small businesses are not willing to receive additional training or educational courses even if they know that this will improve the condition of their business. At the same time, 45.4% of micro business representatives and self-employed have do not wish to get additional training, with the majority (57%) of the least successful among them preferring to avoid taking additional courses. Strikingly, women in our selection were much more open to new knowledge compared to men.

## Motivation

As one could assume, the motivation of the small business representatives on the one hand and micro-business and the self-employed on the other is different. Family-centered motivation is present in both groups rather as marginal.

One in four entrepreneurs from both groups declared that their primary motivation is to be their own boss with women mentioning this point a little more frequently than men. The difference between the groups was, however, in mentions of “no better chance for work”: one in three micro entrepreneurs mentioned this as a reasons why did they engage in entrepreneurship, while only 1 in 13 small business representatives mentioned this as the main reason of maintaining their activity. Another dichotomy is the orientation to the job security, which is more frequent among micro entrepreneurs. Thus, we can assume that the main difference in motivation between small and micro businesses is that micro entrepreneurs are seeking income security, while small entrepreneurs want to increase their income.

**Figure 6. Selected motivations for continuing their activity, among small and micro businesses**



Note: Size of income refers to subjective assessment of income by the representatives of micro business and the self-employed people

As we can see, even those having relatively high income among micro entrepreneurs, mention “no better choice for work” at least in 20% of cases, which is much higher than that

of small entrepreneurs. The level of education also affected the answer – those having higher education were less likely to mention “no better chance for work” among micro entrepreneurs. Stronger motivation among better educated could be result of better understanding of the activity they are engaged in and also relatively high income among them.

However, the difference in motivation between small entrepreneurs and micro entrepreneurs on the initial phase of their enrollment in the business is often negligible (excluding those who earn enough just to survive). Thus, to a large degree, differences in perceptions between small and micro entrepreneurs are caused by the level of success and not the individual approach.

**Table 4. Reasons for engaging in entrepreneurship, small and micro businesses**

	Small business	Micro business and self-employed, earning enough to			
		Total	live norm./ comfortably	live simply	survive
Increase personal income	36.3	38.8	47.9	47.3	29.7
Just to maintain income	20.6	32.5	14.5	23.5	47.0
Greater independence	17.6	14.9	20.5	13.5	12.5
Status	19.6	9.4	11.1	11.5	6.9
DK/RA	5.9	4.4	6.0	4.1	3.9

As we have already seen income and motivation are a “two-way street” showing a clear interconnection and interdependence. In fact, the amount of income and scope of activity is for many more important and more stable. In both groups of entrepreneurs, the question “would you stop doing what you do for the same fixed salary as an employee” was asked. Only 11% of small businesspersons would agree with this prospect. Among the representatives of the micro business, the frequency of responses was dependent on the level of income. 20% of those who consider their earnings enough to “live comfortably” or “normally” were ready to become a wage earner compared to 30% of those who earned “enough to live very simply” and 38% of those who earn enough to just “survive.” Given the volatility of incomes of the self-employed and micro business representatives (present in small businesses at a smaller scale), it can be surprising. It turns out that practical necessity (income stability) is overlapped by psychological factors (status issues – independence, position in society). Moreover, it turns out that the motivation of not only the micro business owners, but even the most of the self-employed is close to the motivation of small business representatives.<sup>37</sup>

However, despite the question mentioning the preservation of income size, revenue still might be a key factor here. Given the significant share of the shadow economy in Armenia’s GDP, it is rather difficult to collect data on the business revenues. In nation-wide surveys, people tend to understate their income. According to the PovcalNet database, in 2014, people have reported their average monthly per capita consumption expenditure at 39.5 thousand

<sup>37</sup> Especially, noting that by definition, small business is an enterprise having between 10 and 50 employees, which is often not viewed “small” in Armenia, given the small size of the labor market

Armenian dram.<sup>38</sup> The national accounts data for the final household consumption expenditure are much higher – around 114 thousand dram<sup>39</sup> (2.88 times higher). Although there still might be a methodological issue, regarding the data, including the involuntary selection bias in poverty surveys, or the national accounts data inaccuracy, the difference – almost 3 times – is too high in any case. For instance, in Denmark, where the share of the shadow is much lower, both figures are very close to each other – the difference is just 4%.<sup>40</sup>

We faced the same issue in our survey: many businesspersons refused to answer our question on the size of their revenue, others could underestimate it slightly or even multiple times, thus the data itself can be less reliable. Thus, one of the possible explanations to commitment to the current activity could be fear of losing informal income.

## Revenues

As already mentioned, many entrepreneurs did not answer the question concerning their firm's monthly revenue. Non-response rate for this question was 26.4% among micro entrepreneurs and 40% among small entrepreneurs. The data on monthly revenue thus should be considered “less reliable” – it gives us just very approximate understanding of what was the real size of income of entrepreneurs.

**Table 5. Monthly revenue of enterprises (survey data)**

	Micro-business and self-employed			Small business		
	N	%	% (excl. DK&RA)	N	%	% (excl. DK&RA)
Less than 3 mln AMD	339	67.3	91.4	28	27.5	(46)
3 – 10 mln. AMD	31	6.2	8.4	12	11.8	(20)
10 – 20 mln AMD	0	0.0	0.0	8	7.8	(13)
20 – 50 mln AMD	0	0.0	0.0	4	3.9	(7)
More than 50 mln AMD <sup>a</sup>	1	0.2	0.3	9	8.8	(15)
Don't know	64	12.7		16	15.7	
Refuse to answer	69	13.7		25	24.5	
Total	504	100	100	102	100	100

Note: <sup>a</sup> Most probably a mistake and should fall under the first category

The vast majority of micro business enterprises and the self-employed reported that they had a monthly income less than 3 mln AMD (6,250 USD). It can be assumed that those who had higher incomes tend to refuse to disclose their incomes, thus the percentage excludes those who did not answer might misrepresent the general picture. Yet, the statistical data can provide us with a general understanding of the situation in the field, however, most probably these data will also underestimate the real size of incomes, due to inability of counting the shadow turnover and income generated by it.

<sup>38</sup> World Bank PovcalNet database <http://iresearch.worldbank.org/PovcalNet/home.aspx>

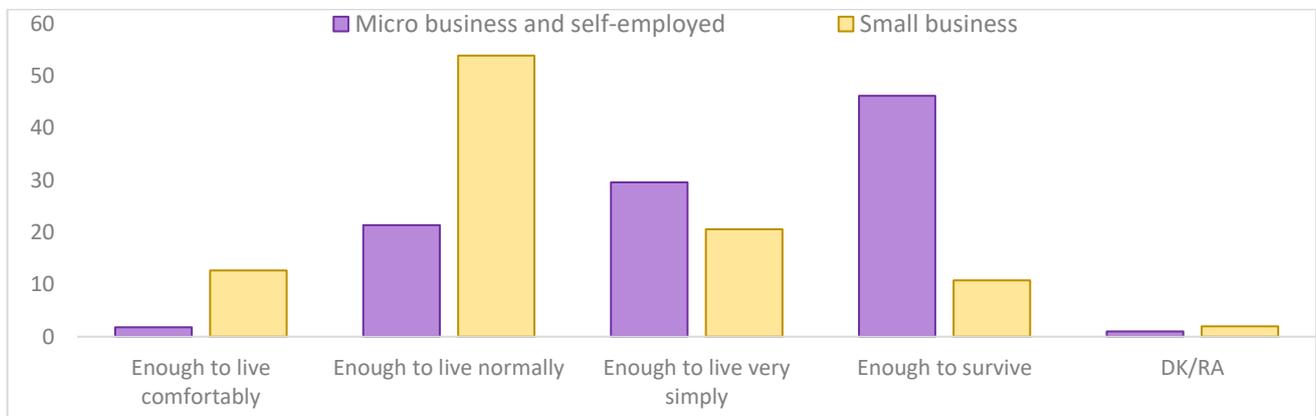
<sup>39</sup> Calculation is based on the official data

<sup>40</sup> Author's calculation based on 2012 data on national accounts and poverty and income surveys

The data on the subjective well-being of micro business representatives can support this assumption. 41% of those, who assessed their income as sufficient “to live normally” did not answer the question on the revenue, 27% of those who said they can “live very simply” on their revenue did not answer the question and only 18.5% of those who said they can just “survive” on their revenues did not answer the question on their revenue.

Subjective assessment of the income is also a non-reliable source for income estimations, however, it still might be useful. First, virtually all entrepreneurs have answered this question. Second, even if it does not provide us with numerical values, it is a tool for understanding the self-assessment of the businessperson at the time of interview. If we assume that the desired income does not vary much among the self-employed, micro-entrepreneurs and the small businesspersons, the data can be used for comparison purposes and for cross-tabs.

**Figure 7. Subjective assessment of revenue**

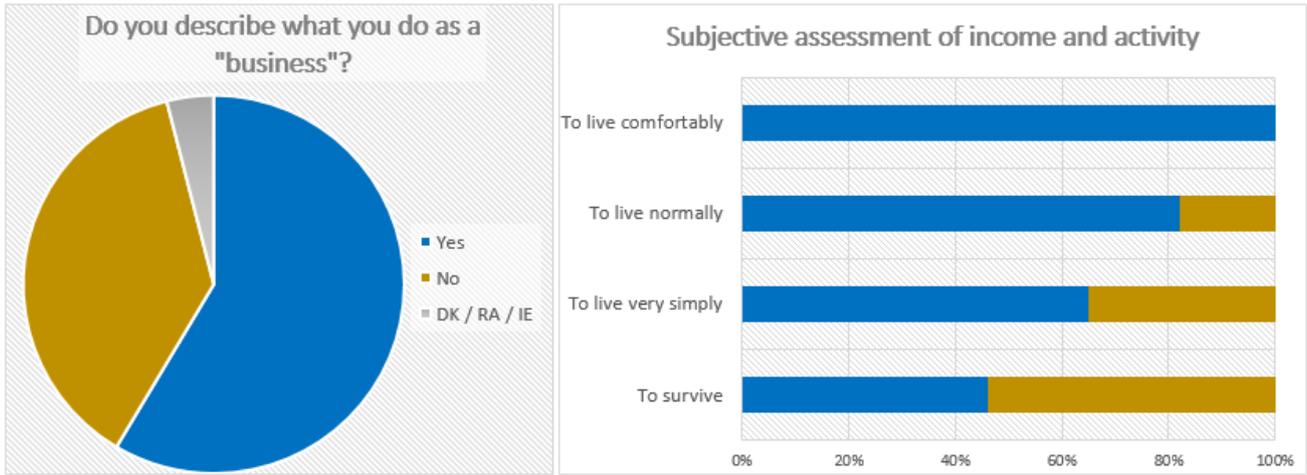


Note: the question wording was “Do you think that you earn enough revenue from your business?”

From these data we can see that while the average small business representative earns enough to afford most of their needs, most of micro-business representatives and the self-employed work just to escape poverty. Less than one in four from the sample of micro entrepreneurs and the self-employed said that they earn enough either to live comfortably or normally. Thus, the question arises – is micro-business in Armenia actually a business – or just a matter of survival? Further underlining this, 89% of surveyed said they cannot save any money.

Over a half of micro entrepreneurs described their activity as a “business” while almost two in five did not agree with the statement. As expected, the lower the revenue (in this case, perceived), the lower becomes the share of those who think that they are doing business. Starting from a certain scale, people start appreciating their work less and do not consider themselves businesspeople. The survey results show that a majority of those who earn enough just to escape poverty do not conceive of their activity as “business.”

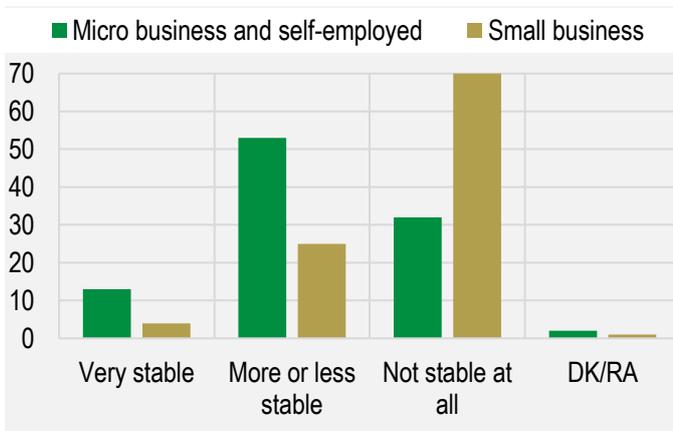
**Figure 8. Subjective assessment of the type of activity**



Note:

Another significant difference between the small and micro businesses is the stability of business activity and revenue. It is also crucial for self-esteem as a businessperson. Microenterprises which have more stable income tend to consider their activity as business. However, most of micro-entrepreneurs (around 70%) described their revenue as highly unstable, while only a third of small entrepreneurs had the same opinion about their revenue. 13% of small businesses in our sample had very stable income compared to just 4% of micro businesses. The results are presented in the chart below.

**Figure 9. Level of stability of incomes**



Most of the entrepreneurs surveyed expressed skepticism concerning the current situation of their business and the latest trends. Just around 11-12% of both samples said that their business situation has improved over the past 6 months. Looking at mid-term trends, micro entrepreneurs were pessimistic: 62% said that overall their business is decreasing, 22% said it is stagnating and just 10% said it was growing.

## Enterprise population of Armenia

### Statistical data

The Ministry of Economy publishes statistical reports on the population of micro, small and medium enterprises of Armenia based on the data provided by the Tax Service. According to these reports, during last two years Armenian SMEs have registered growth in number of enterprises, size of turnover, amount of taxes paid, excluding the number of employees, which has dropped significantly. Notably, the growth of the amount of paid taxes has exceeded growth rates of the total turnover and has led to doubling of tax payments by the medium enterprises and significant increase of payments by small and micro enterprises. Increasing the rate of taxation has been one of the primary goals of Armenia's governments during the last decade within the campaign of combating the shadow economy.

**Table 6. Summary data on Armenia's enterprise population in 2014-2016**

	2014			2015			2016		
	micro	small	medium	micro	small	medium	micro	small	medium
Number of enterprises (active taxpayers)	68117	5109	1139	69939 (102.7)	4905 (96.0)	1112 (97.6)	71606 (102.4)	5272 (107.5)	1368 (123.0)
Number of employees (1000s)	137.3	113.1	119.1	137.4 (100.1)	109.6 (96.9)	118.3 (99.3)	101.6 (73.9)	91.9 (83.9)	108.5 (91.7)
Total turnover (billion drams)	417.3	524.5	624.1	439.6 (104.1)	536.0 (101.0)	635.3 (100.6)	578.1 (130.8)	593.4 (110.2)	649.7 (101.8)
Taxes paid (billion drams)	58.0	87.2	92.5	61.2 (104.3)	95.4 (108.1)	118.9 (127.0)	89.6 (145.7)	110.9 (115.7)	193.3 (161.8)
Taxes paid (as share of turnover, %)	13.9	16.6	14.8	13.9	17.8	18.7	15.5	18.7	29.9

Note: figures in brackets indicate Y-o-Y growth rates, in % to the previous year, where 100.0 indicates no change, less than 100 indicates decline and more than 100 indicates growth. Growth rates in total turnover and amount of paid taxes were adjusted to the GDP deflator (101.2% in 2015, 100.5% in 2016)

Source: Ministry of Economy of Armenia / SME Indicators <http://www.mineconomy.am/en/449>

The data presented by the Ministry of Economy is enough to draw a portrait of an “average” firm. By using these figures, we can calculate the number of employees per firm, according to its size and branch of economy; size of turnover; amount of taxes paid, the share of taxes paid relative to turnover and other. Unsurprisingly, micro enterprises pay less taxes relative to their turnover than small and medium enterprises. In 2016, micro enterprises tax payments comprised 15.5% of their total turnover compared to 29.9% - by the medium business. Since this is the Tax Service data, one can assume that the actual figures should be lower since many of Armenian enterprises, irrespective of size, understate their turnover to avoid or decrease tax payments. However, the extent of informality is different: micro businesses and the self-employed seem to have a higher share of shadow activities.

**Table 7. Size indicators of Armenian SMEs (number of employees per firm and size of turnover per firm), by the economy sector (2016)**

	Number of wage employees			Turnover (mln. AMD)		
	Micro	Small	Medium	Micro	Small	Medium
Agriculture, forestry, fishery	2.17	18.8	67.8	7.0	83.0	626
Mining and quarrying	4.05	17.1	90.6	11.8	87.7	448
Manufacturing, including:	2.41	20.0	86.2	8.0	101.3	483
Non-food	2.25	20.4	85.1	8.7	110.8	501
Food	2.66	19.5	87.9	6.9	88.1	455
Construction	4.29	20.1	83.8	16.2	125.8	499
Trade and repair	0.81	13.6	55.5	8.2	160.9	593
Transportation and storage	3.67	19.6	67.3	12.1	74.5	356
Accommodation, food service	2.80	20.0	92.6	6.5	62.1	357
IT, communication	2.99	18.9	91.6	10.9	88.8	433
Education	5.23	21.9	91.7	5.3	29.1	189
Health, social work	6.02	19.0	109.9	15.8	66.1	329
Arts, entertainment, recreation	2.50	21.0	85.1	3.8	48.3	286
Other	1.75	17.7	85.8	6.7	98.5	447
Total	1.42	17.4	79.3	8.1	112.6	472

Source: Ministry of Economy of Armenia / SME Indicators <http://www.mineconomy.am/en/449> ; author's calculation

## Survey data

The main areas of activity for small entrepreneurs are services and trade, where services altogether make up 57% in our database. Micro entrepreneurs and self-employed are much more likely to be involved in trade: only 27% of micro businesses and self-employed are engaged in services. It should be mentioned that the higher the level of education, the less likely the person is going to be involved in trade. Yerevan residents are also less likely to be involved in trade and more likely to work in services.

In 2015, 80% of the self-employed worked in agriculture,<sup>41</sup> however, as mentioned in the “Methodology” section, those self-employed in agriculture were not included in this survey. Noteworthy, 56% of self-employed work in informal sector.<sup>42</sup> Most of farmers in Armenia do not pay any tax to the central government, but they pay some local taxes on land and property. Nevertheless, if farmers are excluded, national statistics and the survey data are almost matching each other.

**Table 8. Fields of business activity, survey vs official data<sup>43</sup> (2016)**

<sup>41</sup> Statistical Yearbook of Armenia. National Statistical Service of Armenia, Yerevan, 2016, p. 68

<sup>42</sup> Ibid, p. 69

<sup>43</sup> Number of active taxpayer SMEs in 2016. Ministry of Economy of Armenia. <http://mineconomy.am/media/2017/04/1928.pdf>

	Micro enterprises and self-employed	Micro enterprises	Small businesses	Small business
	Survey	Tax service	Survey	Tax service
Agriculture <sup>a</sup>	0.4%	0.5%	1.0%	1.2%
Industry and construction <sup>b</sup>	3.2%	10.0%	17.6% <sup>d</sup>	22.3%
Trade and repair <sup>c</sup>	69.6%	62.5%	27.5% <sup>d</sup>	31.3%
Services	26.8%	26.9%	53.9% <sup>d</sup>	45.1%
<i>N (valid)</i>	503	71606	102	5272

Notes:

<sup>a</sup> Agriculture, hunting and forestry, fishing

<sup>b</sup> Mining and quarrying, manufacturing, electricity, gas and water supply, construction

<sup>c</sup> Trade, repair of vehicles, personal and household goods

<sup>d</sup> Two of companies that mentioned “services” as their primary activity field, were moved to “trade and repair” section and one – to “industry and construction” on the basis of detailed answers regarding the nature of services they were providing.

The difference between the survey and statistical data is rather small. In both cases, the share of industrial and construction enterprises has been underestimated. Nevertheless, the main reason for the sampling “bias” was regional distribution, because fieldwork was conducted only in Yerevan and Lori provinces, while significant portion of Armenia’s food industry is located in Ararat province, mining industry – in Syunik.

Most of the enterprises did not have a second activity, with only 10% of small businesses and 4.4% of micro businesses and the self-employed mentioned that they engaged in a second activity. At the same time, 17% of those who were running small business, were operating at least one more business and 8.5% of micro business operators had another business. Both second activities of the small and micro firms and the second firms owned by the small and micro business owners were much more likely to involve in agriculture (around 1 in 6 of firms having 2<sup>nd</sup> activity and the second firms of business owners).

2% of small business representatives<sup>44</sup> said that they work alone, while the rest stated that they have employees. Average number of hired employees, declared by the respondent, consisted 17 employees per firm. Meanwhile, around one third of the companies were below the minimum size of a small business in Armenia (according to definition, 10 employees), and 4% of firms were above the maximum (50 employees) and should have been considered large business. The discrepancy could be explained by the instability of the companies or the informal part of their businesses. 79.4% of small business representatives stated that they do not use occasional unpaid help from family members, while the rest involved in average 2.2 family members in occasional unpaid labor.

<sup>44</sup> Except for the sole business owners, there were executive directors, chief accountants, and co-partners among the respondents

## Readiness to undertake risk and rate of survival of enterprises

The willingness to take risks to a large extent determines the ability of a business to produce a new product service or to master a new market. For this reason, readiness to undertake risks is one of the key characteristics of any business especially at the initial stage of its development. At the same time the willingness to take risks often leads to the downfall of a company since it is difficult to guess the direction of the market development, otherwise it will be necessary to settle for a small share in the market.

The rate of failure is often underestimated by business players themselves, but overestimated by analysts, who consider that 90% of startups fail within a year.<sup>45</sup> In the USA, according to their detailed statistics on entrepreneurship, only one in five businesses fail within a year, and one in five survive after 20 years of operating.<sup>46</sup> We can use the survey data on the duration of business operation:

**Table 9. The duration of business operation, by size of business (% of total)**

	Small business		Micro business and self-employed	
	Raw data	Corrected	Raw data	Corrected
1-3 years	10.8	11.3	32.1	33.3
4-6 years	26.5	27.8	25.2	26.1
7-10 years	19.6	18.6	14.5	12.1
11-20 years	29.4	30.9	14.5	19.5
21 year and more	7.8	10.3	6.7	8.4

Note.

Correction of data included levelling of 10-year peaks at 10 and 20 years by allocating 1/3 of the peak value to the successive interval value, and the exclusion of DK, RA and the interviewer error values

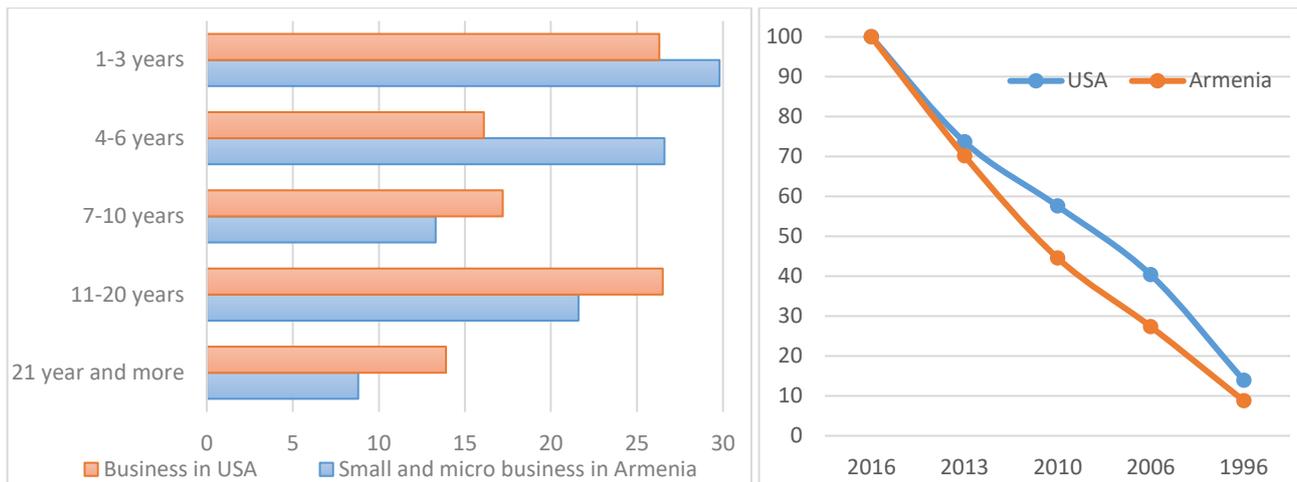
The question formulations were different for small and micro businesses representatives. Small businesses were asked “When did you start your business,” while micro businesses – “For how long have you been doing what you do now?”

There is no official statistics regarding the survival of Armenian enterprises, however comparing the data from Table 8 with American statistics could provide us with an approximation regarding the survival rate in Armenian enterprise population.

**Figure 10. Duration of business operation (left) and share of existing firms, created before the specific date, Armenia and USA**

<sup>45</sup> Neil Patel. “90% Of Startups Fail: Here's What You Need To Know About The 10%,” Forbes, Jan 16, 2015. <https://www.forbes.com/sites/neilpatel/2015/01/16/90-of-startups-will-fail-heres-what-you-need-to-know-about-the-10/#652c0c2b6679>

<sup>46</sup> Entrepreneurship and the U. S. Economy. Chart 3. Survival rates of establishments, by year started and number of years since starting, 1994–2015, in percent. US Department of Labor [https://www.bls.gov/bdm/entrepreneurship/bdm\\_chart3.htm](https://www.bls.gov/bdm/entrepreneurship/bdm_chart3.htm)



Sources: Data for USA enterprise population was calculated based on the data presented by the United States Department of Labor; Author's calculation; Survey data (2016)

Figure 7 reveals that the share of existing firms established 10 years ago and more is lower in Armenia than that in the United States. The most obvious explanations for that are difference in survival rate, and difference in growth rates of new established enterprises. At the same time, given that the entrepreneurship was forbidden in the USSR and no legal private enterprises could exist more than 29 years ago, the late emergence of entrepreneurship could also provide the explanation of the difference. For the latest period, one can assume that the survival rate of Armenian small and micro enterprises by the 4<sup>th</sup> year is about 55% compared to 61.5% in USA (all enterprises). NOTE not comparable

Risk readiness in Armenia varies depending on size of business. Just 29% of micro entrepreneurs said they were ready to take risks compared to 47% among small entrepreneurs. 24% of micro entrepreneurs have already taken risks during the past 6 months compared to 38% respectively. However, size of income affects risk readiness even more than size of business. Those micro-entrepreneurs, who perceive their income as relatively high, tend to behave similarly to small entrepreneurs, while only one in five out of those, who earn enough just to survive, are prepared to take risks.

**Table 10. Readiness to undertake a risk to develop firm, by size of enterprise and perceived income**

	Small business	Micro business and self-employed by subjective income		
		Enough for normal/ comfortable life	Enough to live simply	Enough just for survival
Ready to risk	47.1	44.4	30.2	21.0
Not ready to risk	49.0	54.7	65.8	76.0
DK/RA	3.9	0.9	4.0	3.0

Unwillingness to undertake risks is caused by the high cost of failure for the micro entrepreneurs, especially those who did not have stable income or earned enough just to survive. More than two in three of them expressed fear of failure while proposing new product to the market. This again raises the question to which extent they could be considered entrepreneurs. Observations on micro business representatives and the self-employeds'

motivation and readiness to take risks bring us to the idea that there is an informal threshold which divides micro business operated as a business from self-employment, which is mainly used as a means for survival. Since there are no better benchmarks of income than relative assessment of income and consumption, we may rely on it. In some cases, the average income group appears to be closer to the small business, in other cases to the self-employed. Thus, it is actually close to the threshold dividing business from the minimal earnings as a self-employed.

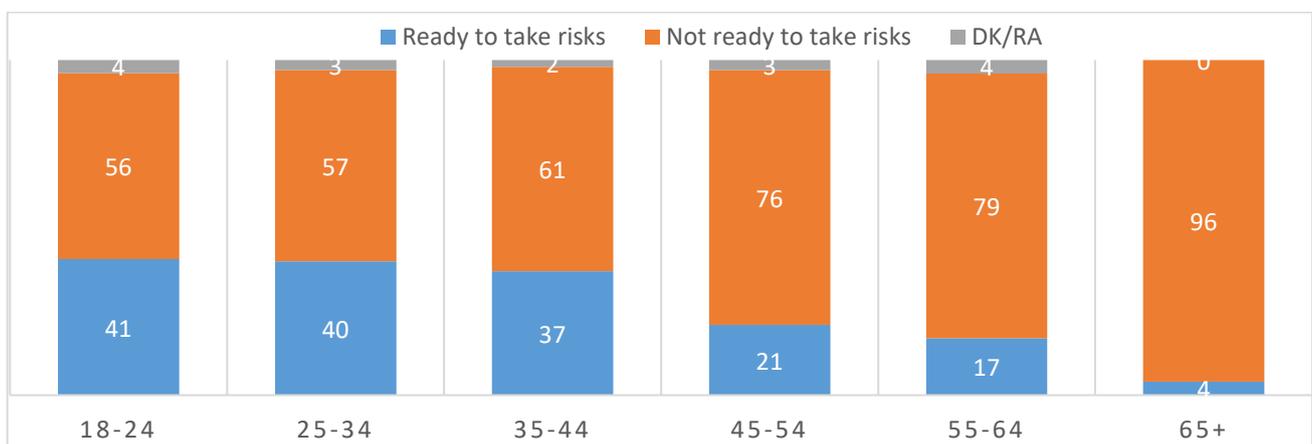
**Table 11. Fear of failure as blocking motivation for new entrepreneurial activity (by size of business and subjective assessment of revenue)**

	Small business	Micro business and self-employed by perceived income		
		Relatively high	Average	Earning enough for survival
Fear	44.1	48.7	60.4	67.8
No fear	50.0	49.6	36.9	29.6
DK/RA	5.9	1.7	2.7	2.6

Note. Question formulation was “Would fear of failure prevent you from starting a new business, or proposing new product or new services”

In-depth consideration of demographic, educational and other personal characteristics of representatives of the micro business representatives reveals other patterns. Sex does not affect the willingness to take risks. Education has positive correlation with a willingness to take risks: 33% of entrepreneurs with higher education are willing to take risks compared to those who had professional (27%) or general education (24%). Marital status also affected readiness to undertake risk: 36.3% of those who were single declared readiness to risk compared to 30% of divorced, 28.7% of currently married and just 6.3% of widowed. However, when it comes to the actual experience of taking a risk, those widowed are much more likely to take the risk, while those who are married were in practice escaping the risks. Jointly 36.2% of those who were not married by the time of interview took the financial risks in the period of 6 months before the interview, while just 20.4% of those were married took the risks in the corresponding period. Age had even greater impact on the willingness to take risks.

**Figure 11. Readiness to take risks to develop their business among micro entrepreneurs, by age**

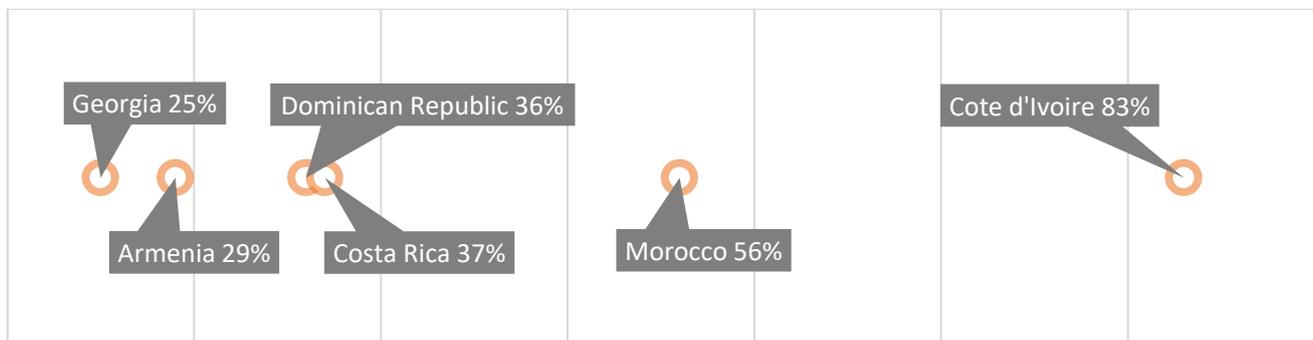


## Institutions

### Formal and informal activities

The informal sector is prominent in Armenia. As in most of developing nations, a significant share of the total number of employed is concentrated in the informal sector. The National statistical service of Armenia estimates the share of informally employed to account for 49% out of the total number of employed (average in 2013-2015), but mostly concentrated in agriculture.<sup>47</sup> At the same time, one in five employed outside of agriculture was informally employed.<sup>48</sup> OECD survey on Public policies, migration and development detected a higher share of informality at 29%.<sup>49</sup> Armenia can be compared to the other developing nations that were included into the study.

**Figure 12. Share of non-agricultural workers without former labor contracts (% of employed)**



Given that fieldwork in Armenia was conducted in early 2015, these results come close to the author's estimate of the shadow economy – 35% of the GDP in early 2015 and 28% of the GDP as of the end of August 2017.<sup>50</sup> Informal economy would not be able to generate such a significant share of GDP, as the shadow economy of Armenia includes a lot of activities that were conducted by the registered firms, including large enterprises, which try to partly evade paying taxes. Since large enterprises also might not register all of their employees, the share of informally employed outside of agriculture can be a good benchmark to understanding the prevalence of the shadow economy in the overall economic activity. Overall, the shadow economy has been shrinking in size during the past decade, passing 30% threshold lately, and despite some fluctuation, this trend still continues in 2017.

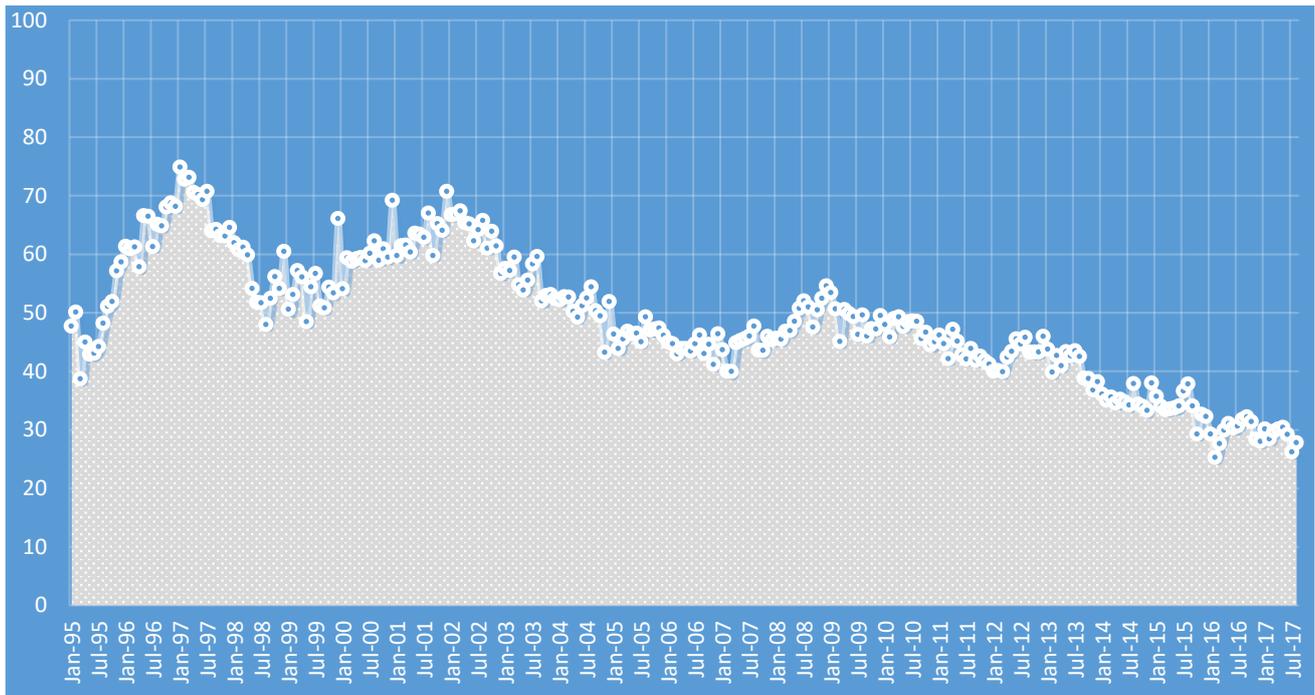
**Figure 13. Monthly dynamics of the shadow economy in Armenia in 1995-2017 (share of GDP)**

<sup>47</sup> "Statistical Yearbook of Armenia," National Statistical Service of Armenia, p. 69. <http://www.armstat.am/file/doc/99499388.pdf>

<sup>48</sup> As per statistical convention, agricultural workers are usually excluded from such measures

<sup>49</sup> OECD. Interrelations between Public Policies, Migration and Development, OECD Publishing, Paris, 2017. P. 184

<sup>50</sup> Hrant Mikaelian, "Shadow Economy in Armenia." Caucasus Institute, 2017 (in Rus). [http://c-i.am/wp-content/uploads/shadow\\_econ\\_print\\_1.pdf](http://c-i.am/wp-content/uploads/shadow_econ_print_1.pdf)



Source: Author's calculation, based on modified Gutmann's method<sup>51</sup>.

Our survey included several questions that can be used as informality-determining variables. Most of small businesses tend to operate formally: they have accounting records and sign written contracts. They still might hide part of their turnover, but the general trend is towards the formalization of their activities. Micro businesses predominantly have accounting records as well, however most of their contracts are informal ones. They do not use written contracts and tend to contact their counterparts orally. One in three micro enterprises do not have a bank account, whereas one in twenty small businesses do not have a bank account.

**Table 12. Informality among small and micro businesses**

	Small businesses	Micro businesses
<i>Do you hold an accounting record?</i>		
Yes	88%	69%
No	12%	31%
<i>Do you operate with contract and written terms of transaction or mainly orally?</i>		
Mainly orally	24.5%	69.2%
Mainly with written terms and contract	74.5%	29.4%
DK/RA	1%	1.4%
<i>At this time, do you have a bank account?</i>		
Yes	94%	66.3%
No	5%	33.1%
DK/RA	1%	0.6%

<sup>51</sup> Ibid

Individual entrepreneurs, micro businesses and family enterprises in Armenia are granted the right to not fill all the tax receipts – in most cases they pay fixed amount of money. Thus, they can remain in a formal economic environment without complete accounting. Yet, an inclination to using oral contracts clearly indicates that they prefer to not register all of their turnover and activity.

## Corruption

According to the Enterprise Survey (conducted by the World Bank in 2013), corruption practices are much more common among small and medium business than among big businesses. Big businesses in Armenia are not very many in number and given the small size of the local market, they play an essential role in its economy and governance. They can be supervised by the authorities more effectively and contacted directly.

**Table 13. Corruption incidence by size of the firm, by country**

	Armenia	Azerbaijan	Georgia	Romania	Serbia	Turkey	Ukraine
Bribery incidence (percent of firms experiencing at least one bribe payment request)							
Small	6.7	14.1	2.0	9.5	5.6	7.6	50.4
Medium	9.1	17.9	3.2	10.7	8.4	2.2	52.0
Large	1.9	18.2	1.1	8.6	1.2	1.3	45.0
<b>Total</b>	<b>7.1</b>	<b>15.9</b>	<b>2.2</b>	<b>9.8</b>	<b>6.1</b>	<b>5.4</b>	<b>50.4</b>
Bribery depth (% of public transactions where a gift or informal payment was requested)							
Small	5.6	12.6	1.2	5.2	4.5	3.5	45.0
Medium	8.4	16.0	1.6	8.1	5.3	1.0	44.9
Large	0.8	10.5	1.1	7.2	0.7	0.9	41.9
<b>Total</b>	<b>6.1</b>	<b>13.8</b>	<b>1.3</b>	<b>6.1</b>	<b>4.5</b>	<b>2.5</b>	<b>44.7</b>
Percent of firms expected to give gifts in meetings with tax officials							
Small	5.6	13.1	0.0	6.9	3.7	1.6	47.9
Medium	5.1	12.0	0.0	6.2	4.3	0.5	54.1
Large	0.6	10.1	1.6	9.3	1.2	0.4	46.4
<b>Total</b>	<b>4.6</b>	<b>12.5</b>	<b>0.2</b>	<b>6.8</b>	<b>3.7</b>	<b>1.2</b>	<b>50.0</b>
Percent of firms expected to give gifts to secure government contract							
Small	8.6	22.3	1.9	6.8	n/a	6.2	100.0
Medium	0.0	59.1	0.0	9.2	22.1	23.8	98.2
Large	0.0	n/a	n/a	1.1	n/a	55.3	99.6
<b>Total</b>	<b>2.7</b>	<b>43.7</b>	<b>1.1</b>	<b>7.1</b>	<b>40.2</b>	<b>18.6</b>	<b>99.1</b>
Percent of firms expected to give gifts to get an operating license							
Small	0.0	4.1	0.0	3.1	0.0	15.3	39.5
Medium	28.3	54.7	n/a	10.9	29.5	9.2	11.0
Large	1.8	26.8	n/a	10.3	n/a	0.3	56.5
<b>Total</b>	<b>10.6</b>	<b>35.2</b>	<b>0.0</b>	<b>5.8</b>	<b>6.4</b>	<b>9.8</b>	<b>35.0</b>

Percent of firms expected to give gifts to get an import license							
Small	2.9	9.5	n/a	0.0	0.4	0.0	78.2
Medium	0.0	71.8	...	0.0	0.0	2.0	15.1
Large	0.0	n/a	n/a	n/a	0.0	1.7	23.7
<b>Total</b>	<b>0.8</b>	<b>38.8</b>	<b>0.0</b>	<b>n/a</b>	<b>0.3</b>	<b>1.3</b>	<b>41.9</b>
Percent of firms expected to give gifts to get a construction permit							
Small	24.8	n/a	13.5	12.0	13.9	3.1	67.6
Medium	19.7	n/a	22.2	18.8	13.5	3.4	94.3
Large	16.6	n/a	0.0	0.9	0.6	0.4	29.0
<b>Total</b>	<b>20.9</b>	<b>40.8</b>	<b>11.5</b>	<b>12.9</b>	<b>12.2</b>	<b>2.5</b>	<b>73.1</b>
N	360	390	360	540	360	1344	1002

Note: According to the ES methodology, a company is considered small if it has between 5 and 19 employees, medium – 20-99 employees and large – more than 100. 26% of companies that fell into the small business category according to our survey would be considered medium in the World Bank survey.

Source: Enterprise survey (2013)<sup>52</sup>

As we can see from the table above, corruption incidence among large business is negligible, except for getting construction permits, while it is much bigger among small business. However, it does not follow that large business is free of informality – it just operates on higher level, where a patron-client relationship is the main informal practice, instead of bribery, which exists on the lower level. Big businessmen can stay in contact with political authorities as well as top level tax service officers, police or other public entities.

Compared to the region of Eastern Europe and Central Asia, Armenia had a lower level of corruption in business administration (7.1% bribery incidence against 18.0% in the EECA region, and 6.1% bribery depth against 14% in the region), but higher compared to Georgia and most of Central European countries. Noteworthy, in some of the countries, small business faces bribe requests less frequently than medium and big business.

## Paying taxes and tax morale

The high share of the shadow economy until mid-2013 itself implicitly affirms that the extent of tax avoidance is high. One of the main reasons for that is low tax morale<sup>53</sup>. Many people in Armenia find justifiable avoiding tax paying and cheating on taxes as they consider that government does not sufficiently fulfill its social commitments or consider that due to corruption in financial authorities, the money will be misused anyway. There is also a perception that the taxes (especially, income and turnover tax) are too high and should be decreased<sup>54</sup>. Despite substantial decrease of tax rate for SMEs, many still consider that the

<sup>52</sup> World Bank Enterprise Surveys portal. <http://www.enterprisesurveys.org/>

<sup>53</sup> Hamid Davoodi and David Grigorian. "Tax Potential vs. Tax Effort: A cross-Country Analysis of Armenia's Stubbornly Low Tax Collection." IMF Working paper, N°106, 2007 [https://www.imf.org/~media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/wp/2007/\\_wp07106.ashx](https://www.imf.org/~media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/wp/2007/_wp07106.ashx)

<sup>54</sup> According to the Tax Perceptions Survey, conducted in 2013, between half and three fourth small business representatives considered that tax rates are too high.

"Taxpayer perceptions in Armenia. Households and enterprise survey 2013." CRRC, 2014, pp. 126-127.

tax rate is high – 36% of small business representatives named it a major or very severe obstacle to their business, while 32% said it is either minor or no obstacle to the business. Another important reason for tax avoidance is the common perception that different businesses are treated differently, which makes competition unfair for those who pay all the taxes<sup>55</sup>.

As we have seen, big businesses actually face different treatment and are in some cases given an informal “license” for tax evasion. They use shadowy accounting practices and hide the actual size of their turnover. During the past decade, authorities increased their pressure on the enterprises, forcing them to pay all the taxes. Big businesses started to extensively use more sophisticated methods of tax evasion, including offshore jurisdictions, which were not available for SMEs. The government has admitted to the problem and even insisted that tax reform will affect only the big businesses.<sup>56</sup>

Small and micro entrepreneurs also evade taxes, however they face a much bigger risk of being caught and consider that tax inspectors have a presumption of guilt in their dealings with taxpayers. A recent study on Armenia’s tax efficiency has shown that many SMEs manipulate size of their turnover to fall behind the administrative threshold under the progressive tax.<sup>57</sup>

Nevertheless, during past decades, tax morale has increased, as becomes clear by analyzing various surveys results. If in 1997, just around tax evasion ‘never justifiable’; in 2011, three out of every four considered it as such.

**Table 14. Perceptions on tax evasion in Armenia**

	1997	2008	2011
Never justifiable (1-2)	49.4%	69.4%	76.5%
Not justifiable (3-4)	12.3%	12.6%	9.3%
In several cases (5-6)	15.2%	7.4%	6.3%
Justifiable (7-8)	9.4%	5.3%	3.5%
Always justifiable (9-10)	10.9%	5.4%	3.3%

Note: the question wording was: “Please tell me for each of the following actions whether you think it can always be justified, never be justified, or something in between”

Sources: WVS, 1997<sup>58</sup>; EVS, 2008<sup>59</sup>; WVS, 2011<sup>60</sup>

Although these results refer to nationwide poll and are not specialized to business community, we can assume that businesses are also far more likely to report their turnover

[http://www.crrc.am/hosting/file/\\_static\\_content/projects/Tax%20Reform%20Project/CRRC-Tax-Reform-Project-Eng.pdf](http://www.crrc.am/hosting/file/_static_content/projects/Tax%20Reform%20Project/CRRC-Tax-Reform-Project-Eng.pdf)

<sup>55</sup> Ibid, p. 136

<sup>56</sup> H. Abrahamyan: We attach great importance to development of SMEs. Aysor.am news agency, September 23, 2014. <https://www.aysor.am/en/news/2014/09/23/hovik-abrahamyan/847727>

<sup>57</sup> Zareh Avetisyan, Andreas Peichl, “Response of Firms to Tax, Administrative and Accounting Rules: Evidence from Armenia.” ZEW, Discussion Paper #16-065. <http://ftp.zew.de/pub/zew-docs/dp/dp16065.pdf>

<sup>58</sup> World Values Survey wave 3. Fieldwork in Armenia was conducted in 1997

<sup>59</sup> European Values Study, 4<sup>th</sup> wave. Fieldwork was conducted in 2008

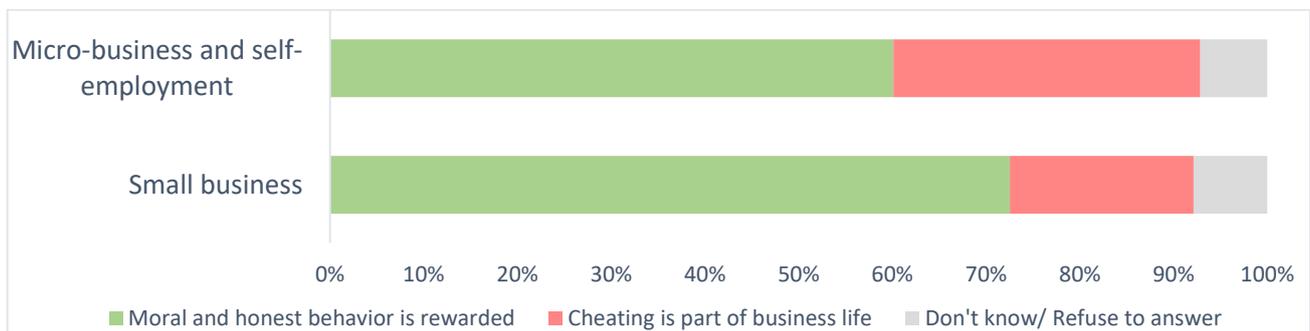
<sup>60</sup> World Values Survey wave 6. Fieldwork in Armenia was conducted in 2011

and pay taxes today as ratio of tax revenue to GDP has grown significantly during the past decade<sup>61</sup>. Armenia's results in international rankings have also improved. According to "Paying Taxes-2010", Armenia, along with most of the states in Eurasian sub-region, was at the bottom of the list – it took only 153<sup>rd</sup> position (out of 183) in the world when considering the ease of paying taxes. The report referred to the period of late 2008-early 2009.<sup>62</sup> In the last report, "Paying Taxes-2017," Armenia took 88<sup>th</sup> rank (out of 189) in the same statistic, thus surpassing the global median.<sup>63</sup>

Of course, given the nature of the question, the percentages in Table 14 should not be taken all too literally. In surveys, people tend to give more morally accepted answers. At the same time, behavior depends on the existence of sanctions for illegal actions. Tax avoidance has become more difficult recently, and consequently people view it to be less acceptable.

Our survey of the business community has also shown that businesspeople tend towards more honest behavior both with the authorities and their business partners. While among small business, only one in five consider that cheating is part of business life, one in three micro business representatives the self-employed think so. Thus, morality in business highly depends on the size of enterprise, which brings us back to the results of the Enterprise survey, according to which the bigger business is in Armenia, the less chance of dealing with bribery it has (see Table 13).

**Figure 14. Business morale in Armenia**



No significant cheating preference were found among the self-employed and micro-entrepreneurs neither by age, nor by the income, education or even self-esteem. The only factor that affected behavior was the duration of business experience. The shorter the experience was, the less people considered cheating as a part of business life. Thus, if among those who had experience between 1 and 3 years, 26.5% considered cheating normal, among those who were doing business more than 6 years, the number was as high as 36.6%. At the same time, the share of those who saw moral behavior as beneficial, was the same among all groups – those who were initially unexperienced and undecided shifted with time towards acceptance of cheating.

<sup>61</sup> The data on tax revenue as a share of GDP is available on Trading Economics website. <https://tradingeconomics.com/armenia/tax-revenue-percent-of-gdp-wb-data.html>

<sup>62</sup> "Paying Taxes 2010. The global picture." World Bank group, PWC, 2010. <https://www.pwc.com/gx/en/paying-taxes/assets/paying-taxes-2010.pdf>

<sup>63</sup> "Paying Taxes – 2018". World Bank Group, PWC, 2017. <https://www.pwc.com/gx/en/paying-taxes/pdf/pwc-paying-taxes-2017.pdf>

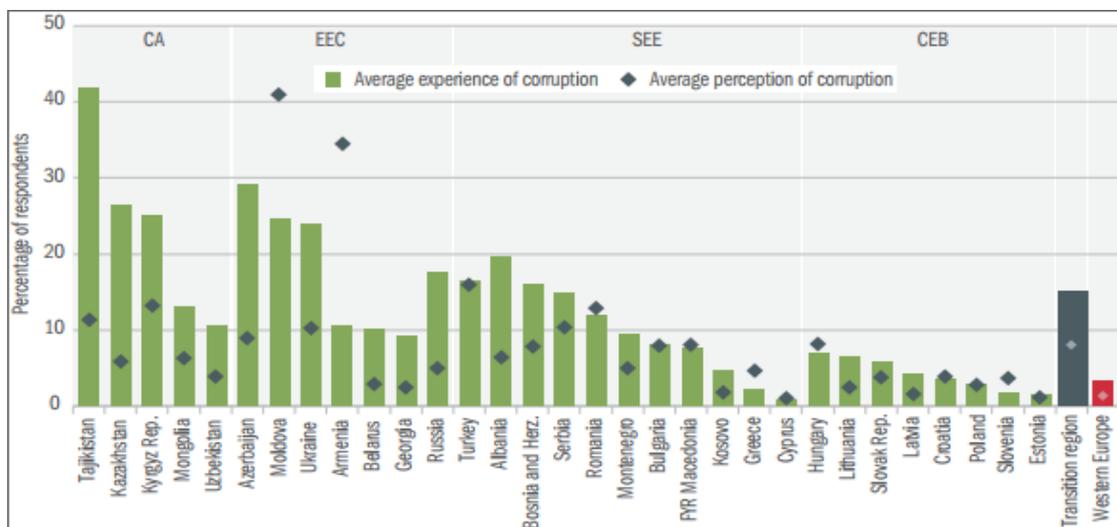
There is another important reason why micro businesses and self-employed tend to have lower business and tax morale compared to small entrepreneurs. 70% of micro businesses in our sample are engaged in trade, while trade had by far the highest share of shadow in Armenia compared to all other branches of the economy<sup>64</sup>.

## Trust in institutions

Public opinion in Armenia is characterized by a low level of perceived happiness<sup>65</sup> and a high level of distrust towards a variety of institutions. This includes both a large portion of state institutions<sup>66</sup>, and even the non-governmental sector<sup>67</sup>. The level of mistrust in Armenia is traditionally high, but as a result of the economic crisis of 2008-2010, as well as the political tension that existed against this background, it grew even more. This applies to public opinion in general, as well as representatives of business and even people involved in public administration.

The high level of distrust towards state institutions is also affects the perception of reality. According to the Life in Transition Survey, conducted in 2016, perception of corruption in Armenia was much higher than actual corruption experience. 35% of surveyed said, “people like themselves usually of always have to make unofficial payments of gifts when dealing with public services” (averaged across all public services covered by the survey), while 10% respondents (or their family members) have made unofficial payments or gifts in the 12 months preceding the survey<sup>68</sup>. The perception gap was highest among all surveyed countries.

**Table 15. Experience versus perception of corruption in different countries**



<sup>64</sup> Bagrat Tunyan, “The Shadow Economy of Armenia: Size, Causes and Consequences.” World Bank Armenia - Working paper 05/02, p. 11. Jan. 2005 <http://pdc.ceu.hu/archive/00002657/01/WP0502.pdf> p.11

<sup>65</sup> Jon Clifton. The Happiest and Unhappiest Countries in the World. Gallup, March 20, 2017. <http://news.gallup.com/opinion/gallup/206468/happiest-unhappiest-countries-world.aspx>

<sup>66</sup> Bertelsmann Foundation Transformation Index 2018. Country Report – Armenia. [http://www.bti-project.org/fileadmin/files/BTI/Downloads/Reports/2018/pdf/BTI\\_2018\\_Armenia.pdf](http://www.bti-project.org/fileadmin/files/BTI/Downloads/Reports/2018/pdf/BTI_2018_Armenia.pdf)

<sup>67</sup> Yevgenya Jenny Paturyan, Valentina Gevorgyan, “Civic Activism as a Novel Component of Armenian Civil Society.” Turpanjian Center for Policy Analysis, 2016. <http://tcpa.aua.am/files/2016/08/Civic-Activism-as-a-Novel-Component-of-Armenian-Civil-Society.pdf>

<sup>68</sup> “Life in Transition. A decade of measuring transition”, EBRD, p. 29. <http://www.ebrd.com/documents/oce/pdf-life-in-transition-iii.pdf>

Source: EBRD Life in Transition Survey (Wave III, 2016)

The low level of trust towards state institutions is itself a problem and is caused by the socio-political dynamics within the country. We can consider the level of confidence in Armenia in comparison with its neighbors, Georgia and Azerbaijan, which have a common past and a comparable level of economic development.

**Table 15. The level of trust and perception of institutions in the South Caucasus (percentage)**

Question formulation	Armenia		Azerbaijan		Georgia	
	Trust	Mistrust	Trust	Mistrust	Trust	Mistrust
Most people can be trusted	17	58	26	40	18	52
Trust towards country's banks	32	35	48	24	27	36
Trust towards country's court system	15	55	33	28	24	27
Trust towards country's educational system	49	27	65	16	43	17
Trust towards country's healthcare system	41	32	49	35	49	15
Trust towards country's government	21	59	56	22	26	30
Trust towards country's police	29	46	48	26	51	16
Trust towards country's media	23	39	40	22	24	14
Average across 7 institutions	30.0	41.9	48.4	24.7	34.9	22.1
Net trust across 7 institutions	-11.9		23.7		12.7	

Note: the surveys in Armenia and Georgia were conducted in 2017; in Azerbaijan – in 2013

Sources: CRRC 2017<sup>69</sup>; CRRC 2013<sup>70</sup>

Compared to Georgia, Armenia stands out not so much for its low level of trust, but for the high level of distrust towards all institutions and even people. In Azerbaijan, the level of trust in institutions is much higher, which can partly be explained by the closed political system in that country.

Similar results were seen in our study as well. It showed that there is no direct relationship between the actual quality of public administration and the way in which the work of state institutions is perceived. 70% of surveyed small business representatives choose “I don't have any problem” when asked about their relationship with the state administration. 13.5% said they dealt with unfair treatment from tax authorities and 6.3% mentioned business regulations. 61.3% said they think property rights are very well or mostly protected, while the rest thought that property rights were either protected not very well or not protected at all. However, most of the small business representatives disagreed with the statement that the state administration is working quick, impartially and transparent.

**Table 16. Perceptions about the regulatory quality among small and micro business representatives**

The state administration...	Small business		Micro business & self-employed		Combined, weighted	
	Agree	Disagree	Agree	Disagree	Agree	Disagree

<sup>69</sup> CRRC Caucasus Barometer 2017 – Georgia <http://caucasusbarometer.org/en/cb2017ge/codebook/>

CRRC Caucasus Barometer 2017 – Armenia <http://caucasusbarometer.org/en/cb2017am/codebook/>

<sup>70</sup> CRRC Caucasus Barometer 2013 – Azerbaijan <http://caucasusbarometer.org/en/cb2013az/codebook/>

Provides good ground for competition	22.5%	77.5%	7.4%	92.6%	10.0%	90.0%
Is fair, impartial and uncorrupted	16.9%	83.1%	13.4%	86.6%	14.0%	86.0%
Is quick	37.6%	63.4%	29.4%	70.6%	30.8%	69.2%
Is clear and predictable	27.6%	72.4%	21.7%	78.3%	22.7%	77.3%
Takes action to promote small business	28.2%	71.8%	8.8%	91.2%	13.4%	86.6%

Note: “Strongly” and “somewhat” agree options were combined. It refers to “strongly” and “somewhat” disagree. DK and RA answers were excluded.

As we can see from the results of our survey, presented in Table 16, the majority of representatives of small and micro business, as well as self-employed, do not trust the government and consider that regulatory quality is extremely low. Small and micro business representatives as well as the self-employed think that the state administration is neither quick, fair, impartial and uncorrupted, nor clear and predictable. According to all five questions presented in Table 16, representatives of the micro business and the self-employed are more skeptical. At the same time, when asked about major problems with the state administration, 57% из них признали, that they have no relationship with the state administration, while majority of the remaining named high tax rate. Taking into account Armenia’s high positions in the “Index of Economic Freedom” and the “Doing Business” index, we can assume that this perception is caused mostly by the socio-political trends rather than is the actual assessment of the regulatory quality.

Noteworthy, majority of the respondents in both groups were skeptical not only about the state institutions but about the “Armenianness” as well. More than half consider that “Armenian culture does not favor businesspeople”. Just one in three small business representative and one in five self-employed thought, “Armenian culture favors businesspeople.” This reveals significant difference with the results of the survey conducted in Georgia<sup>71</sup>.

<sup>71</sup> “Emergence of Entrepreneurship in Georgia. Midterm Results.” EPRC, May 2014. [http://www.eprc.ge/admin/editor/uploads/files/Broshure\\_200x260mm\\_ENG\\_3.pdf](http://www.eprc.ge/admin/editor/uploads/files/Broshure_200x260mm_ENG_3.pdf)

## Summary

The fieldwork of the survey was carried out during the regional crisis of the post-Soviet economies, when the volatility of exchange rates of regional currencies was noticeable. This affected the business representatives' assessment of the prospects for their development, and in assessing the quality of the work of state institutions. April 2016 has seen a serious escalation of violence in the Karabakh conflict zone, which killed about 100 people only from the Armenian side. However, in general, distrust and fear of risk are chronic problems of Armenia's social life.

Legal entrepreneurship, which was allowed less than thirty years ago, faces numerous prejudices, including preference towards rent extraction, distrust of the market economy and contradistinction of large, medium and small businesses.

Many micro entrepreneurs and self-employed do not consider their activities as a business, which has high correlation with the size of their income. Bearing in mind the least successful of them, we can say that their economic activity is aimed more at survival and therefore it is difficult to consider it a business. However, without perceiving their activity as a business, they also do not find it necessary to exert additional efforts to expand their own business and avoid any risk.

This study practically did not touch upon the agriculture, since people working in this field in Armenia are not inclined to consider their activity as a business, but rather consider themselves unemployed. The lack of an agricultural sector can be considered an omission, but at the same time, agriculture differs from industry, trade and services so much that it requires a separate study.

The regulatory environment in which small and microenterprises operate in Armenia is characterized by a relatively low level of corruption, but the perceived level of corruption is much higher. In many respects, this is due to the fact that micro entrepreneurs avoid contact with state institutions and often do not register their activity: seven out of ten micro-entrepreneurs and self-employed conduct their business contacts mainly orally. The habit of doing business orally is in part a consequence of the Soviet experience, and in part an attempt to avoid tax regulations. However, surveys, conducted in the last two decades in Armenia, show that tax evasion is less and less acceptable for the majority of the population.