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**GDAŃSK UNIVERSITY OF TECHNOLOGY**

FACULTY OF MANAGEMENT AND ECONOMICS

# **UNPRODUCTIVE ENTREPRENEURSHIP - THE CASE OF THE POLISH ECONOMY**

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# Unproductive Entrepreneurship - the Case of the Polish Economy<sup>1</sup>

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## Summary

Unproductive entrepreneurship is not a common theme undertaken by researchers. The author defines the basic concepts of unproductive entrepreneurship and explains the role of cultural and economic differences in transition countries, in terms of institutional environment. However the main aim is to identify the nature of unproductive entrepreneurship in Poland. The theory for the research was based on the Baumol work. The research model on the Ajzen TPB. 270 Polish entrepreneurs were surveyed in order to define and describe unproductive entrepreneurship in Poland. The surveyed entrepreneurs present a permissive subjective standard regarding tax evasion when the existence of their enterprise is endangered, however they are also quite indulgent in the case of desire to maximize profits. The entrepreneurs represent more negative behavioural beliefs regarding the effectiveness of tax avoidance than regarding the effectiveness of making arrangements with tender participants or paying bribes.

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## Introduction

The long-term interest in entrepreneurship and the growing number of studies of the SME sector affect the common understanding that increasing the number of enterprises is always beneficial for the economy. However, not every manifestation of entrepreneurship contributes to the overall well-being of society, even if it is advantageous for the trader themselves. The first one to point to this apparent paradox was William Baumol, who started a discussion on the relationship between quality of law and business environment institutions, business activities, and the total product produced by the business sector (Baumol, 1990). Baumol introduced new types to the study of entrepreneurship, such as productive, unproductive and destructive. This classification was based on a set of actions that require entrepreneurial talents, but do not contribute to improving the overall country production. In some cases such actions might even decrease the general production. Baumol did not analyse the effects of entrepreneurial activities on the company level, but he was mainly interested in the relationship between entrepreneurship and the gross domestic product. However, it can be noticed that entrepreneurial action which is destructive from the point of view of the society can bring profits to the company (Desai and Acs, 2007).

The unproductive and destructive entrepreneurship lived to see many definitions, however the researchers are still looking for a way to test and measure it. The basic problem is the impossibility to accurately distinguish between the two concepts, therefore for the purpose of further considerations only the term of unproductive entrepreneurship shall be used. On the other hand, the sources of unproductivity are known — they are related to inefficient institutions (mainly the formal ones) (Henrekson, 2007).

In the transforming countries, due to the overlapping of old systems with new ones and the necessity to make changes, these malfunctions are more pronounced. Moreover, the functioning and changes in the formal environment of entrepreneurs are also affected by informal institutions, which is a result of historical events and cultural conditions. In the case of Central European countries they include: acquiescence to corruption, cheating the state — especially regarding to taxes or the search for well-connected acquaintances in order to achieve positive solutions in government offices etc. (Welter and Smallbone, 2011) These actions, even if acquiesced to, are unethical and taking them or not will result from individuals' inclinations for behaviours of this type. However, going beyond Baumol's theory of unproductive entrepreneurship, another aspect, being a result of the inefficiency of transforming economy institutions, should be paid attention to. An entrepreneur may be "forced" by inefficient institutions to use their entrepreneurial talents in a unproductive way in emergency situations threatening the existence of the company, resulting from the sluggishness of bureaucrats, their incompetence or poor system solutions.

## Literature background

Discussions on unproductive entrepreneurship were launched in 1990 by W. Baumol (1990), who derived this theory from the institutional economy. Thus, he pointed to institutions — namely their quality — as the central concept related to the theory of productive, unproductive and destructive entrepreneurship. According to Baumol, the allocation of entrepreneurial resources is not due to the supply of entrepreneurs or to the goals they set, but rather to a set of laws and regulations or, sometimes, cultural conditions. The unproductive behaviours of entrepreneurs result from weak institutions which cause the loss to the economy at the macro level, even if a single entrepreneur undertaking measures gains (Hwang, Powell, 1991). Issues related to institutions are being analysed by lawyers, sociologists and economists alike. The latter refers to institutional economics, but less frequently to its classic Veblen interpretation — it concerns rather its contemporary rendition: new institutional economics. The institutionalists, however, do not offer one definition of institutions, although most of them do share the view of North (1991), who considers them to be: „*rules of the game in the society or more formally, the human devised constraints that shape human interaction*”. Hodgson (Hodgson, 2006) clarified the key concepts related to institutions used for scientific analyses, entering into a polemic with North on the nature of the institutions' impact on human activity. North treated institutions as "*The humanly devised constraints*", (North, 1991), while Hodgson thought that the institutions not only constrain but also enable behaviour. This observation of Hodgson is part of a discussion on productive, unproductive and destructive entrepreneurship, however it shows that entrepreneurs are not only victims of malfunctioning institutions but also can use them for their own purposes.

Institutions are seen as inflexible and the changes taking place within them are perceived as slow. The long period of reaction relates specifically to informal institutions. The changes of institutions may also be initiated by entrepreneurs who, through e.g. lobbying, can influence their shape (Henrekson, 2007). However, as highlighted by North, each change of institutions causes postponed impact on individual decisions, including entrepreneurship (North, 1991). Therefore, it may appear that the beneficial institutional arrangements entered into the system may become an obstacle in the case of change of the wider economic, social and political environment.

Henrekson lists four institutions whose poor quality can contribute to unproductive activities — they are: *property rights protection, savings policies, taxation and the regulation of labour markets* (Henrekson, 2007). The entrepreneurs, motivated by a desire for more material benefits, waste their entrepreneurial talents in search of alternative solutions resulting from the failure of these institutions, e.g. by changes in property rights or tax evasion, but also the search for the possibilities of changing the institutions. So understood unproductive entrepreneurship becomes synonymous with the concept of rent seeking (Desai and Acs, 2007), which was defined within the theory of public choice (Dominiak, Wasilczuk and Starnawska, 2016, pp. 67) and refers to the interface of private and public **sector**. „*Rent seeking (...) was the wasting of resources in pursuit of „unearned” profits or wages, which often were obtained through public policies that were widely acknowledged by economists to be counterproductive*” (Congleton, 2015).

Rent seeking is according to Baumol (1990) and others (Desai and Acs, 2007) the primary motive of unproductive entrepreneurship. It includes such activities as litigation, acquisitions, tax evasion and tax fraud, but also using formal institutions to monopolize the market. Other forms of unproductive and destructive entrepreneurship include the illegal and criminal activity, as well as various forms of corruption (Sauka, 2008, pp. 23-24). Illegal activities and crime include the production and sale of illegal substances, racketeering, blackmail etc. In this article, these activities will not be discussed, although it is worth to add, as a side note, that there are emerging voices calling for the need to expand the definition of an entrepreneur by people who deal with activities considered to be criminal in nature (Rehn and Taalas, 2004). Nevertheless, this type of activity should be rather treated as destructive entrepreneurship. Although this form of entrepreneurship was not described by Baumol, it can be intuitively assumed that while unproductive activities of entrepreneurs do not contribute to GDP growth, the destructive actions actually reduce the global product. Using Ricardian concept of rent, it can be said that unproductive entrepreneurship is synonymous with the destruction of rent (Desai and Acs, 2007). The entrepreneur makes a profit through their actions but at the same time destroys the potential production of other enterprises, while not compensating the economy for it. According to Baumol, in the case of unproductive and destructive entrepreneurship only the entrepreneur achieves profit, while the public suffers losses due to their activity (Table 1).

Table 1. Benefits for the enterprise and society versus the productive, unproductive and destructive entrepreneurship

	Productive entrepreneurship	Unproductive entrepreneurship	Destructive entrepreneurship
The entrepreneur's approach to profit and other material benefits	<i>(rent-creating)</i>	<i>(rent-seeking)</i>	<i>(rent-destroying)</i>
Does the entrepreneur achieve profit?	Yes	Yes	Yes
The net impact on GDP	(+)	(0)	(-)

Source: (Desai and Acs, 2007)

In response to the limitations imposed by institutions, businesses may adopt three strategies: abide, avoid or alter. Each of them can relate to activities belonging to both productive and unproductive entrepreneurship (Table 2) (Henrekson and Sanadaji, 2011).

Table 2. Types of entrepreneurship resulting from the attitude to the institution

Attitude to the institutions	Productive entrepreneurship	Unproductive/destructive entrepreneurship
Abide	Actions on the possibilities offered by the institutions.	Litigation to take over part of their profits. Cheating the state
Evading (legally or illegally)	Bypassing market regulation (including labor law) through innovative solutions.	Corruption Illegal syndicates and collusion
Alter	The search for new solutions that contribute to increased overall prosperity without destroying production.	Lobbying for new regulations. Cancellation of property rights, the acquisition of this property.

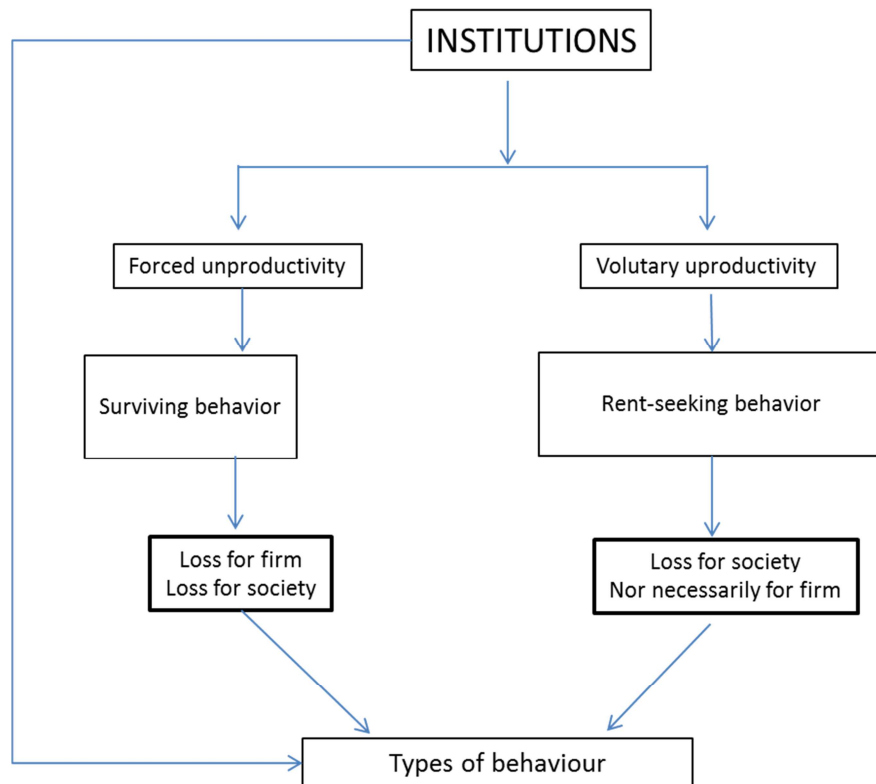
Source: Own, based on: (Henrekson and Sanadaji, 2011).

Respecting institutions while taking advantage of them leads to unproductive entrepreneurship, exemplified by litigation or fraud (for instance tax evasion). The entrepreneurs who avoid institutions (legally or illegally) aim at finding beneficial solutions within the framework of existing institutions. If these solutions are innovative in nature, we can talk about productive entrepreneurship. By contrast, corruption, entering into collusion (e.g. in tenders) or engaging consultants and lawyers to find legal loopholes are expressions of unproductive entrepreneurship. The last strategy is seeking to change the institutions, manifested in the search for solutions that contribute to the overall well-being (productive entrepreneurship) or are beneficial only for the entrepreneur (unproductive entrepreneurship). An example of productive activity can be solicitation of changes in legal regulations relating to entrepreneurs as a group, while an example of unproductive activity is the attempt to lobby for new solutions that bring benefits to a single entrepreneur, e.g. use of connections with politicians in order to obtain exclusive rights to conduct entrepreneurial activities or use/purchase limited resources (e.g. land). Trying to change institutions is not the only response to the restrictions they impose.

The above-described non-productive activities, resulting from the weakness of the institutions, are performed by entrepreneurs seeking to take profits which in a competitive environment would not be theirs. However, inefficient institutions are often a source of danger for entrepreneurs, forcing them to unproductive activities for the sake of remaining in the market. Baumol's theory did not take into account unproductive activities that can be productive for the enterprise. Inefficient institutions, having complete control over the entrepreneur, can lead them to bankruptcy. This may be a result of tardiness (too long to issue conclusive decisions, multiplying difficulties), improper or unclear legal solutions<sup>2</sup>, restrictions described as *red tape* and many other factors. The entrepreneurs in such situations may take actions regarded to be unproductive, such as corruption, tax evasion etc. The motive of these activities is not rent-seeking but the desire to survive in the market. An entrepreneur in both the first and the second case has several options to use their talents. While seeking rent, they consciously abandon activities which are productive for themselves and for the society, deciding to take actions that are often unethical and equal to not following or even breaking legal rules. It is the entrepreneur's free choice. In the second case the entrepreneur has the choice to go bankrupt (or, in the best case, suffer from significant perturbations) or enter the path of unproductive activities. The second option (*second best choice*), although it also causes losses to society in the short term (alternative use of entrepreneurial talents), in the long term can mean the survival of the company, which is also beneficial from the point of view of society (maintaining jobs, employment for the owner etc.). In the case of rent-seeking, the entrepreneur voluntarily decides to perform unproductive activities, whereas in the latter case takes such actions because it is forced by inefficient institutions. Figure 1 shows the effect of institutions on the unproductive actions taken by the entrepreneur — forced and voluntary.

<sup>2</sup> In Poland, where the research described below was conducted, there are numerous examples of such irrational legal solutions.

Fig. 1. Forced and voluntary unproductivity.



Source: own.

The activities undertaken by entrepreneurs (corruption, tax evasion etc.) can be included in the non-productive activities resulting both from rent-seeking and from the desire to maintain the enterprise. Sauka and Welter indicate that some seemingly unproductive activities should be, from the social point of view, classified as productive (Sauka and Welter, 2007).

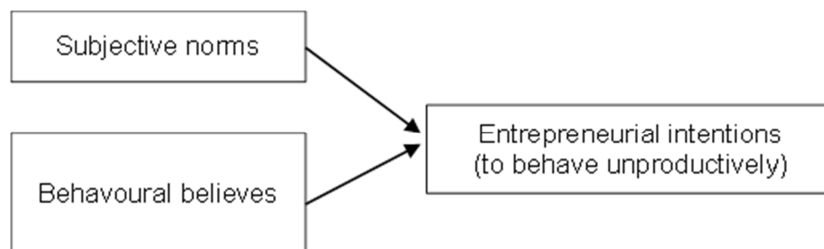
### Research design and methods

Issues related to unproductive entrepreneurship have not been a subject of many empirical studies. This problem was most fully developed for Latvia (Sauka and Welter, 2007). The respondents described their involvement in such unproductive activities as lowering the reported net profit, employment and earnings, using connections and relations, unofficial payments, stealing business ideas, squeezing newcomers out of market, etc.

The studies described below differ from the Latvian ones primarily in terms of the formulation of questions and selection of non-productive activities. The Polish society belongs to the most distrustful ones. The coefficient of confidence in Poland is among the lowest in Europe— in comparison to Scandinavia countries (European Social Survey, 2015), hence asking the entrepreneurs directly about activities from the legal grey area or outright unethical actions entails a risk of refusal to answer (even if the survey is anonymous). This fact has greatly hampered the construction of the questionnaire — therefore the indirect method of diagnosis, used in research of activities on the borderline of the law (Gërkhani, 2007), was employed. As a result, the questions related to typical activities of enterprises from given industries, behaviours commonly accepted in the industry, as well as the evaluation the effectiveness of unproductive activities. It was assumed, according to Ajzen's Theory of Planned Behaviour, that behaviours are affected by intentions (Krueger, Reilly and Carsrud 2000), which in turn result from the expected benefits of behaviours, social norms and self-efficacy (Ajzen, 1991) (Figure 2). In other words, respondents who perceive given behaviours as acceptable (subjective norms) and evaluate them as effective (behavioural beliefs) will be more likely to engage in them. Conversely, those who will point to the lack of effectiveness of such actions and the lack of acceptance will be less likely to engage in them. The study omitted, however, the analysis of the component related to self-efficacy. Thus, the researchers asked questions related to actions considered to be the *second best choice*. Specifically, the respondents were asked to indicate whether they would be willing to perform unproductive activities in case of bankruptcy threat. Again, it

was assumed that an overwhelmingly positive response indicates a high propensity to unproductive activities.

Figure 2. Research model based on Ajzen.



Source: Own based on Ajzen (1991).

### The research results

270 Polish entrepreneurs (of whom 52% were women) were surveyed in order to define and describe unproductive entrepreneurship in Poland. The study included decision-makers in enterprises. The research was limited to four sectors: processing industry (26%), trade (26%), construction (27%) and professional activity (22%). 42% of enterprises were sole proprietorships, 16% were partnerships and 23% limited liability companies. 11% of companies employed up to 9 people, 78% employed 10–49 people, while the others belonged to the sector of medium-sized companies (50–249 employees).

In the first part of the study, in order to determine what subjective standards for selected unproductive behaviours are present among surveyed Polish entrepreneurs, they were asked to answer the following question:

"How much do you agree with the following statement:

- the entrepreneurs in your industry evade paying taxes because it is the only way to survive,
- the entrepreneurs in your industry evade paying taxes because without this they would survive in the market but they want to earn more than others,
- paying a bribe for solving a problem is not objectionable because the legal rules are too complicated and settling matters otherwise is too time-consuming

Respondents' answers were placed on a scale of 1 to 5, where 1 meant "I strongly disagree", 2 - "I rather disagree", 3 - "I have no opinion", 4 - "I rather agree" and 5 - "I strongly agree". The obtained answers to this question are presented in Table 3.

Table 3. The results of answers to the question "How much you agree with the following statement..."

		I strongly disagree	I rather disagree	I have no opinion	I rather agree	I strongly agree
Evading taxes in order to survive	R	15	53	97	79	26
	%	5%	20%	36%	29%	10%
Evading taxes in order to earn more	R	16	51	109	73	21
	%	6%	19%	40%	27%	8%
Paying a bribe is not objectionable because...	R	50	76	83	44	17
	%	19%	28%	31%	16%	6%

Source: own work.

The analysis of the results shows that the largest category of answers in each of the questions used to assess unproductive behaviour is the answer "I don't know". The highest percentage of such



responses (40%) was obtained in the case of the statements "The entrepreneurs in my industry avoid paying taxes because they want to earn more than others", whereas the relatively lowest percentage (31%) was obtained in the case of the statement "paying a bribe for solving a problem is not objectionable because the legal rules are too complicated and settling matters otherwise is too time-consuming". This way of answering questions related to sensitive ethical issues may indicate a reluctance to express one's opinion. The analysis of the other answers indicates that the respondents are more inclined to agree with the statement: "the entrepreneurs in your industry evade paying taxes because it is the only way to survive" (39% — aggregated results "I rather agree" and "I agree"; 25% — aggregated results "I rather disagree" and "I disagree") and with the statement: "the entrepreneurs in your industry avoid paying taxes because without this they it would survive in the market but they want to earn more than others" (35% — aggregated results "I rather agree" and "I agree"; 25% — aggregated results "I rather disagree" and "I disagree"). On the other hand, they respondents clearly do not agree with the statement: "paying a bribe for solving a problem is not objectionable because the legal rules are too complicated and settling matters otherwise is too time-consuming" (47% — aggregated results "I rather disagree" and "I disagree"; 22% — aggregated results "I rather disagree" and "I do not agree").

The statistical analysis using the "t-Student test for dependent groups" revealed the existence of statistically significant differences between the respondents' answers to statements related to tax evasion and giving bribes. The results are shown in table 4.

Table 4. The results of the t-Student test showing statistically significant differences in the responses received to questions about tax evasion vs. questions about giving bribes. The responses are placed on the scale: 1 "I strongly disagree" – 5 "I strongly agree".

	Average 1 (taxes)	Average 2 (bribes)	t	p
1. evading taxes in order to survive vs. 2. giving a bribe is not objectionable because...	3.17	2.63	5.76	0.00001
1. evading taxes in order to earn more vs. 2. giving a bribe is not objectionable because...	3.11	2.63	5.20	0.00001

Source: own work.

The average of responses to the question on bribery was lower (2.63) than the average obtained for both questions regarding evasion of taxes (3.17 and 3.11).

This means that the surveyed entrepreneurs present a permissive subjective standard regarding tax evasion when the existence of their enterprise is endangered, however they are also quite indulgent in the case of desire to maximize profits. On the other hand, the non-permissive standard is presented in relation to paying bribes to expedite or facilitate business matters.

The second part of the study was aimed at determining which behavioural beliefs regarding selected unproductive behaviours are present among the surveyed Polish entrepreneurs. That is why they were asked to answer the following question:

Do you think that in our (Polish) economy the following measures are effective:

- Making arrangements with tender participants
- Paying bribes
- Evading taxes

The respondents had a choice of the following responses: "Yes, very much." "Yes, sometimes", "I don't know", "Probably not" and "Definitely not". The obtained answers to this question are presented in table 5.

Table 5. The answers to the question: "Do you think that in our economy the following measures are effective:"

		Yes, very much	Yes, sometimes	I don't know	Probably not	Definitely not
Making arrangements with tender participants	R	43	84	33	69	41
	%	16%	31%	12%	26%	15%
Paying bribes	R	36	87	27	58	62
	%	13%	32%	10%	22%	23%
Evading taxes	R	34	81	15	70	70
	%	13%	30%	5%	26%	26%

Source: own work.

With regard to the first two measures, i.e. "making arrangements with tender participants" and "paying bribes", the distribution of positive and negative responses (agreeing and disagreeing with the provided statements) is quite similar. In the case of the answer regarding the effectiveness of making arrangements with the tender participants 41% of respondents believe that such measures are ineffective (26% "rather not" and 15% "definitely not"), whereas 47% consider them effective (16% "very much" and 31% "sometimes"). However, in the case of assessing the effectiveness of paying bribes the results are balanced. 45% of the surveyed entrepreneurs consider such conduct to be effective (13% "very much" and 32% "sometimes"), whereas 45% think it is ineffective (22% "rather not" and 15% "definitely not"). It is a quite interesting result, indicating the dichotomous division of opinions among the respondents.

Interestingly, in the case of the answer to the question about the effectiveness of tax evasion the results differ from those described above. Slightly more than half of respondents (52%) think that such measures are ineffective (26% "rather not", 26% "definitely not"), while 43% consider them effective (13% "very much", 30% "sometimes"). It should also be noted that in the case of questions related to behavioural beliefs the percentage of respondents who choose the answer "I don't know" is much smaller than in the case of questions related to subjective norms.

In order to verify whether the differences are statistically significant, Friedman's ANOVA rank test was used in conjunction with Kendall's coefficient of compliance (a non-parametric alternative to one-factor analysis of variance for repeated measurements). The results of the test (Chi square ANOVA (N = 270, df 2) = 15.28257 p <001; Kendall compliance ratio = 0.02) allow for concluding that those differences are statistically significant. This means that the surveyed entrepreneurs represent more negative behavioural beliefs regarding the effectiveness of tax avoidance than regarding the effectiveness of making arrangements with tender participants or paying bribes.

## Conclusions and discussions

Unproductive entrepreneurship was studied in Poland for the first time. The research allowed to describe the nature of unproductivity, which provokes the discussion about the relation between unproductive entrepreneurship and maturing institutions. Baumol described only the voluntary entrepreneurship. Literature search however, showed that unproductivity should not be only connected with *rent seeking*, especially in transition countries. Thanks to the field research, the authors show that complicated and frequently changing regulations, and weak institutions, being formed since 1990 (the beginning of transformation in Poland) shaped the nature of unproductive entrepreneurship, which in most cases is the forced one. What is more, it seems that Polish entrepreneurs don't know how to use the weak institutions to compete at the market. Thus, Baumol's theory about the allocation of entrepreneurial talent to take over the rent (voluntary unproductivity), in the Polish economy has not been recorded. Entrepreneurs resort to unproductive activities in the search for surviving, but not for the purpose of reducing the production of competing companies.

The conducted study made it possible to determine what subjective standards and behavioural beliefs are present among Polish entrepreneurs for selected unproductive behaviours. The results allow to formulate the following conclusions:

- the surveyed entrepreneurs present a permissive subjective standard regarding unproductive behaviours such as tax evasion when the existence of their enterprise is

endangered (surviving behaviour), however they are also quite indulgent in the case of desire to maximize profits (rent-seeking behaviour). On the other hand, the non-permissive standard is presented in relation to paying bribes to expedite or facilitate business matters. This means that giving bribes compared to paying taxes is perceived through the lenses of subjective standard as more inappropriate.

- the surveyed entrepreneurs represent more negative behavioural beliefs regarding the effectiveness of tax avoidance than regarding the effectiveness of making arrangements with tender participants or paying bribes. Which is quite interesting result. Perhaps it shows a fairly efficient operation of institutions responsible for tax collection.

It should be also pointed out that the percentage of answers "no opinion" regarding the subjective standards is high (40 – 31%) and regarding behavioral beliefs significantly lower (12% -5%). To put the issues objectively, it is difficult to imagine a situation in which the active entrepreneurs operating in the market have no opinion on the actions taken in their business. It seems that in the case of research topics that are "sensitive", in the sense that they deal with behavior that is incriminating or discreditable, this way of responding may serve to hide their opinions and be a choice of safe behavior (Tourangeau, Rips and Rasinski 2000) Obviously, this means modification of the results that can be directly analyzed. On the other hand significantly lower percentage of such answers regarding behavioral beliefs can be explained by the more general question concerning the behavior undertaken by others, and therefore safer in response.

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