

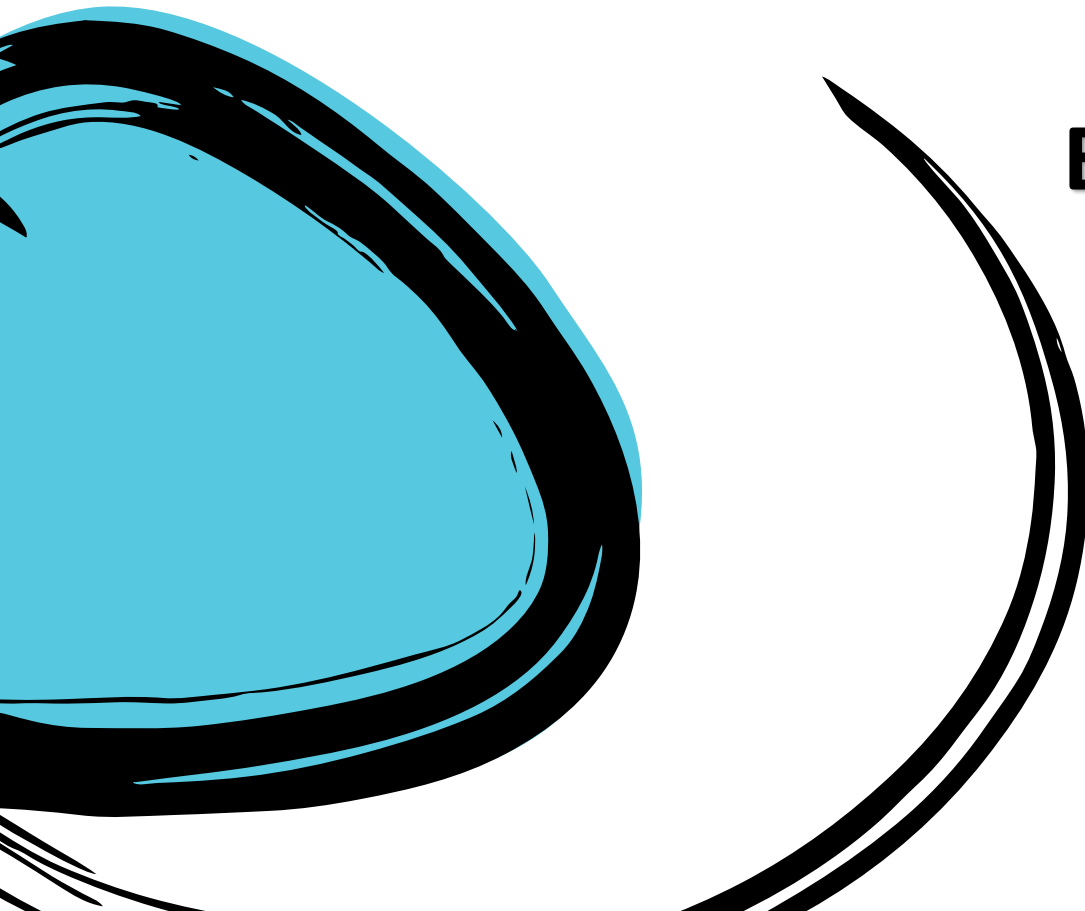


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CENTRE FOR ENTERPRISE AND
ENTREPRENEURSHIP STUDIES

LUBS2045 Week 5 Lecture

Corruption and Entrepreneurship



Overview

- Causes of corruption – often occurs where institutions are weak
- Organised crime and individual entrepreneurs
- Different types of corruption and organised crime emerge in different countries
- The omnipresent nature of corruption in some locations (the 'devil's circle')





What is corruption?

We define corruption as the abuse of entrusted power for private gain.

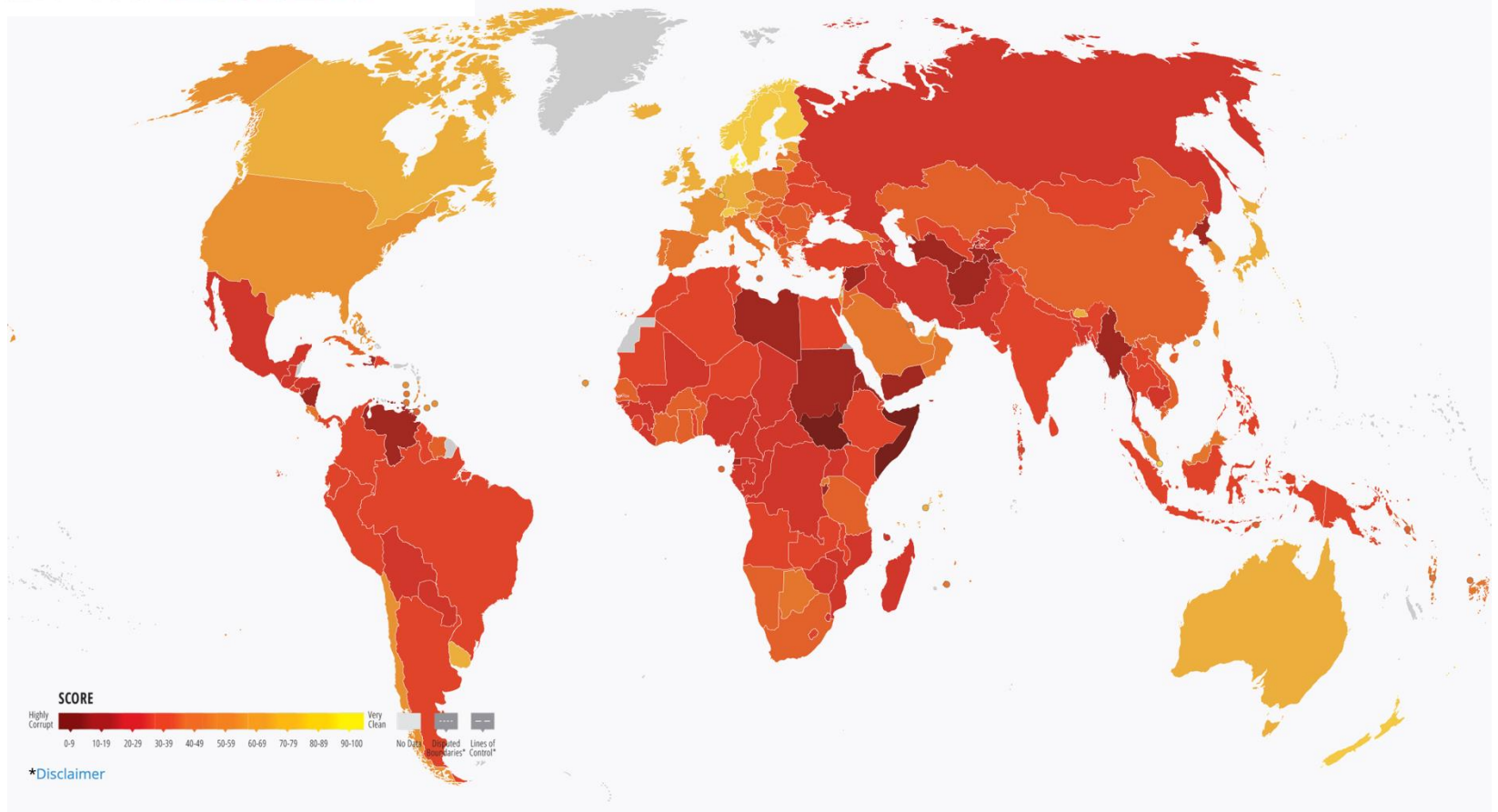
“Corruption will continue to thrive until justice systems can punish wrongdoing and keep governments in check. When justice is bought or politically interfered with, it is the people that suffer. Leaders should fully invest in and guarantee the independence of institutions that uphold the law and tackle corruption. It is time to end impunity for corruption.

François Valérien
Chair of Transparency International

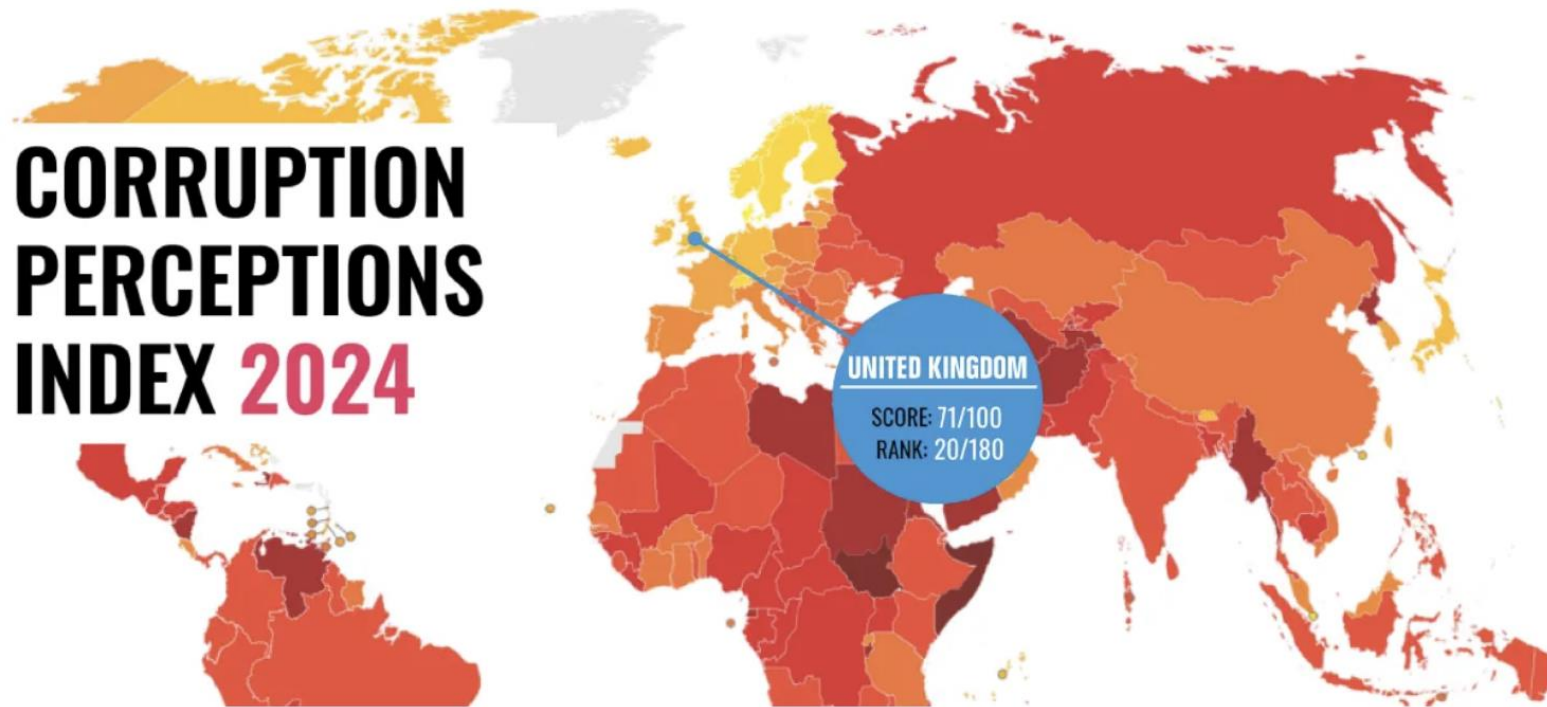


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CORRUPTION PERCEPTIONS INDEX 2024



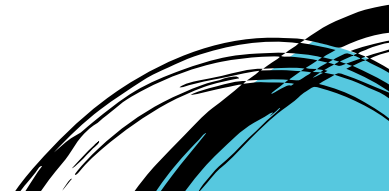
CORRUPTION PERCEPTIONS INDEX 2024



The UK has maintained its lowest ever score in Transparency International's Corruption Perceptions Index (CPI).

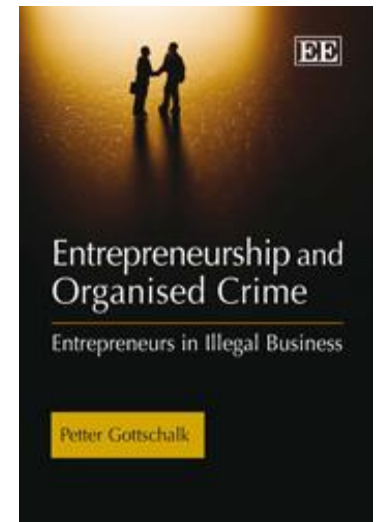
Results published today show the UK's score remains at 71 for the second year running, keeping the UK at its lowest point since the Index underwent a major revamp in 2012. The UK now sits at 20th in the global ranking, a sharp drop from its position just outside the top ten in 2021.

This year's score of 71 despite more recent positive developments in the UK from the new government including commitments from the Prime Minister to restoring integrity in politics. However, the result shows there can be no grounds for complacency in seeking to address integrity issues in the UK.



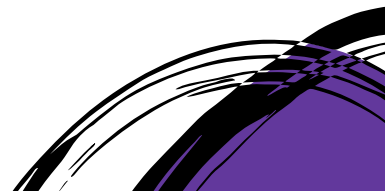
Entrepreneurial opportunities

- Entrepreneurship is the ability to spot and act on opportunities
- Alertness to opportunity is crucial (Kirzner, 1973)
- Entrepreneurs can act on legal and illegal opportunities – both have opportunities for profit
- Entrepreneurs need ability to harness resources to take advantage of opportunities, develop networks –institutional framework is important
- Illegal entrepreneurs often act in the same way as legitimate businesses



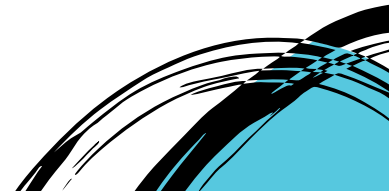
Entrepreneurship - as a deviance

- Entrepreneurial behaviour can be viewed as social deviance
- All deviances create difference and difference creates opportunity
- Deviances are socially unacceptable to a greater or lesser degree
- Arguable that the more unacceptable a deviance the more likely it will be rejected by the mainstream:
 - Pfizer or Wellcome don't sell Crack Cocaine
 - Pearson or Penguin Random House don't publish pornography
- This creates opportunities for people outside the mainstream



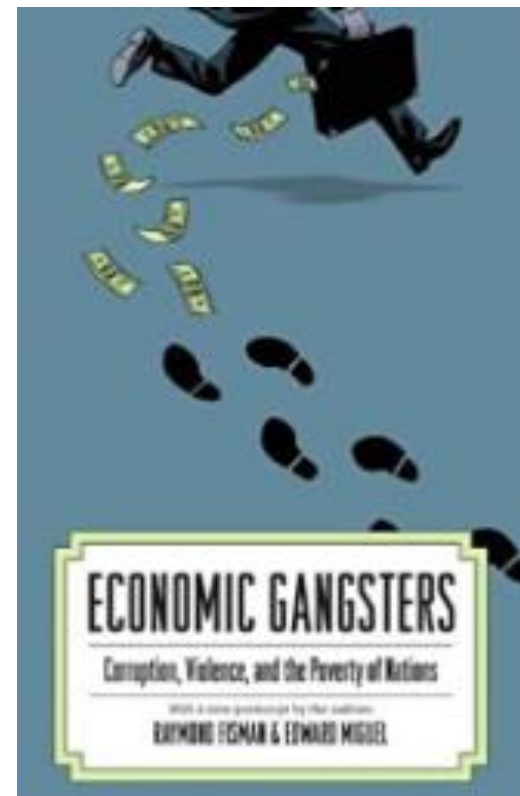
Entrepreneurial opportunities

- Drug Dealing/Bootlegging/Counterfeiting - Individual Entrepreneurship
 - supply and demand
 - individual networks
 - opportunity identification
- Business model used for most illegal drugs is the Razor and Blades model credited to King Gillette.
- Demand is generated through a cheap initial product offer (the Razor) and money is generated by the continual purchase of the additional product (the blades) – e.g. printers and Ink
- Demand is created through a free initial offer (the first fix is free). Once addiction is achieved the addict has few places to go other than the original pusher.



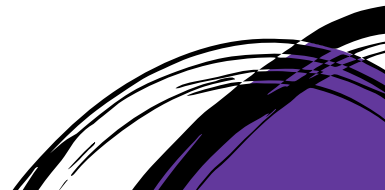
Illegal Entrepreneurship

- The underpinning assumptions of an enterprise culture are that, following Adam Smith's (1776) invisible hand, the combined actions of individuals will lead to and promote the prosperity of a community. Where institutions are weak, this is not necessarily the case.
- Illegal entrepreneurs use the same system of enterprise that legal entrepreneurs do - identify opportunities, make novel combinations of different resources, utilise knowledge and use their network like any other entrepreneurs (Baumol, 2002)
- Also argues that it is the desire to work outside the 'citizenship consensus' that differentiates illegal entrepreneurship. Argues that it is at its most effective where the 'victims' are also outside this consensus.



The role of society

- Developed societies have elevated the role of enterprise and the entrepreneur from peripheral to central in economic growth. This is a significant and recent change.
- Entrepreneurs regarded as engines of growth and catalysts for change. General assumption that entrepreneurship is 'good' for society.
- However, the social impact of entrepreneurial activity is not always positive - a characteristic of entrepreneurship is the exploitation of unoccupied markets and new sources of supply.
- These can be exploited by illegal entrepreneurial activity and have a negative social impact



The role of the law

- 'Legal Highs'
 - e.g. BZP was developed as a worming treatment for cattle and GBL as an industrial cleaner
- Were sold legally through shops and over the internet (distribution channels). Illegal entrepreneurs (and users) had a 2 year window between opportunity exploitation and illegality
- The holders of power intervene and the entrepreneur withdraws
- Legal highs then move into the same distribution channels as other illegal drugs



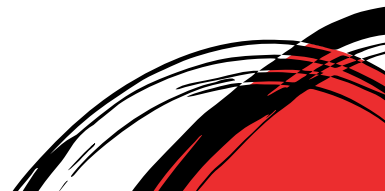
New legislation to tackle "legal highs" was introduced last year

The sale of so-called legal highs has gone underground after a blanket ban

'Legal highs': Street dealers now main source of supply after ban

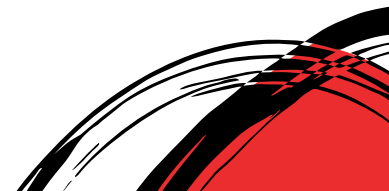
The role of government

- Market changes that yield opportunities are not always caused by entrepreneurs
- Opportunities arise thorough legislation, demographics and changes in the content or structure of knowledge
- Therefore exploiting an opportunity may depend on factors that are out of the control of the enterprising individual
- A key skill required is how to work with or within externally imposed structures and constraints or work outside them
- Weak, unstable governments can be exploited – entrepreneurs balance risks and rewards

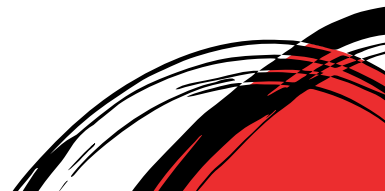


Impacts of corruption

- Corruption reduces economic growth, lowers investment, and erodes trust in government officials, creating an institutional environment that pushes entrepreneurs from productive to destructive activities (Baumol 1990; North 1990).
- Corruption, however, can also have effects at the micro level because some industries are better situated to profit from corruption than others (Boudreaux et al., 2018)
- Corruption not only lowers economic output but also shifts resources toward some industries and away from others
- Corruption can create entrepreneurial opportunities



Some archetypal criminal groups



Archetype 1: Italy

- A standard hierarchy – mafia organised around families with sovereignty over defined territory
- Approximately 25,000 members and 250,000 affiliates worldwide
- Common enterprise is protection racketeering – also drugs, guns, prostitution, cigarette smuggling etc.
 - e.g. of business strategy - mafia infiltration of local councils; infiltration caused some closures



WESTERN EUROPE / EUROPEAN UNION

ITALY

Score

56/100 [What does the CPI score mean?](#)

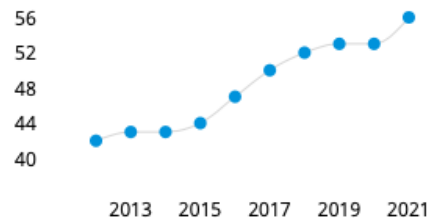
Rank

42/180

Score change

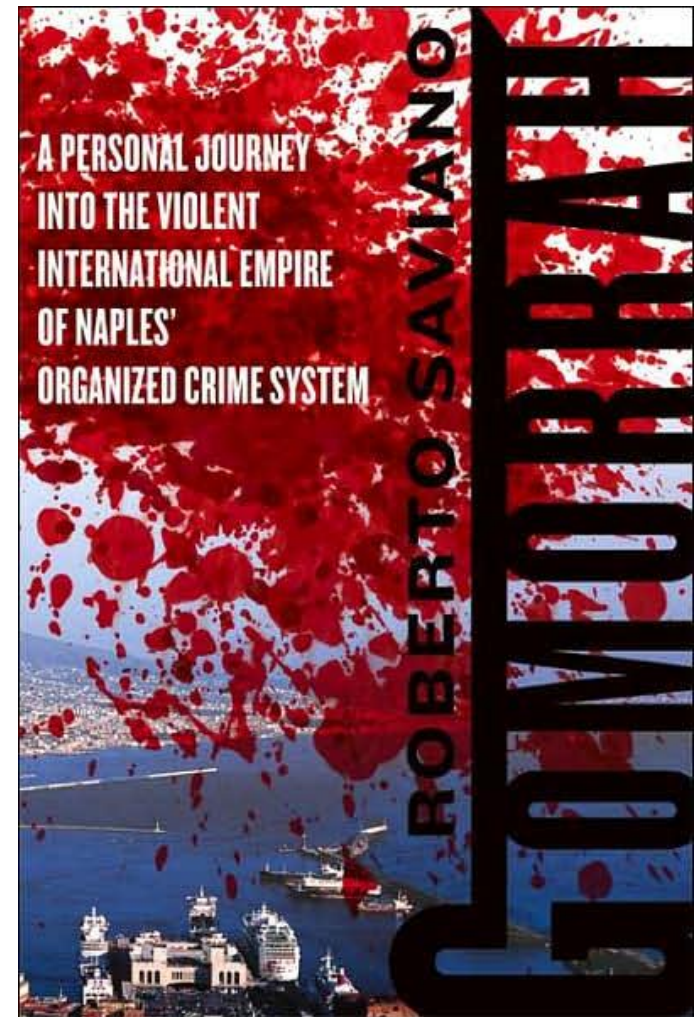
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Score changes 2012 - 2021



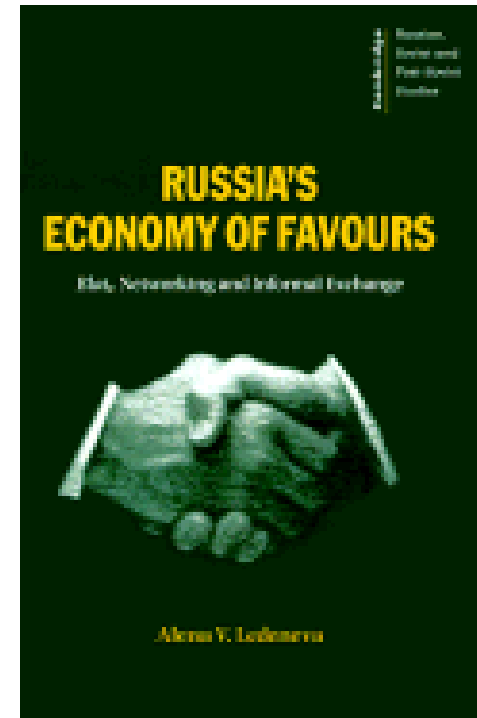
The Camorra

- Based in Naples, Campania
 - one of the highest murder rates in Europe, one of the world's highest ratios of drug dealers to inhabitants, soaring levels of unemployment and cocaine addiction, and elevated cancer rates linked to toxic waste dumping
- Control of port of Naples
 - 1.6 million tons of Chinese merchandise are unloaded a year, and another million pass through without a trace, evading taxes



Archetype 2: Russia

- Informal practices are the norm
- Impacts on investment into Russia – destroys value of entrepreneurial activities
- System of 'blat'
 - appeared in the Soviet Union to denote the use of informal agreements, exchanges of services, connections, Party contacts, or black market deals to achieve results or get ahead
 - Concept has developed to apply to criminal networks and business networks



EASTERN AND CENTRAL EUROPE

RUSSIA

Score

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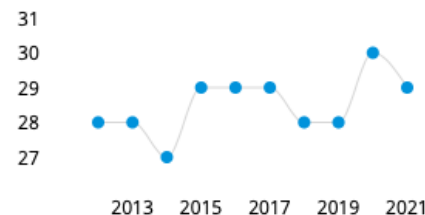
Rank

136/180

Score change

↓ -1 since 2020

Score changes 2012 - 2021



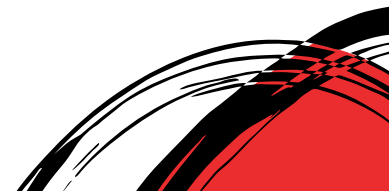
Organised crime in Russia

- Russia considered to have largest and most powerful mafia in world
- In Soviet era *vory v zakone* ('thieves-in-law') emerged as leaders of prison gangs
- Honour code emerged and with fall of Soviet Union the gangs exploited unstable government
- At its height controlled two-thirds of the Russian economy



Culture

- Capital Economics: "While corruption and problems within business environments are common across emerging markets, Russia appears to have a particularly bad reputation."
- Russia has been variously described as kleptocracy, oligarchy, plutocracy (due to 'crony capitalism')
- Impacts on culture of entrepreneurship



Research on Bulgaria and Romania

**Between petty corruption
and criminal extortion: How
entrepreneurs in Bulgaria
and Romania operate within
a devil's circle**

Tim Vorley and Nick Williams

International Small Business Journal

1–21

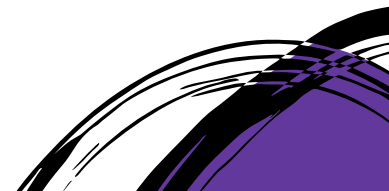
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Bulgaria

- Bulgaria often considered to be the most corrupt country in Europe
- Drugs, people trafficking, prostitution rings, smuggling of stolen cars and murder
- Links to politics crucial for 'businessmen'
- Culture of 'thick necks'
- 2020-2021 Bulgarian protests



WESTERN EUROPE / EUROPEAN UNION

BULGARIA

Score

42/100 [What does the CPI score mean?](#)

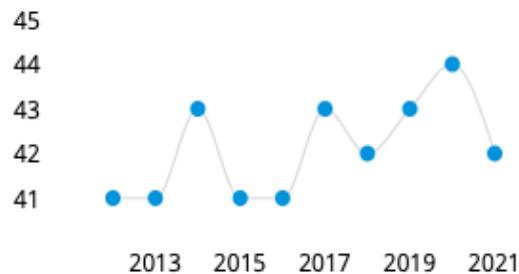
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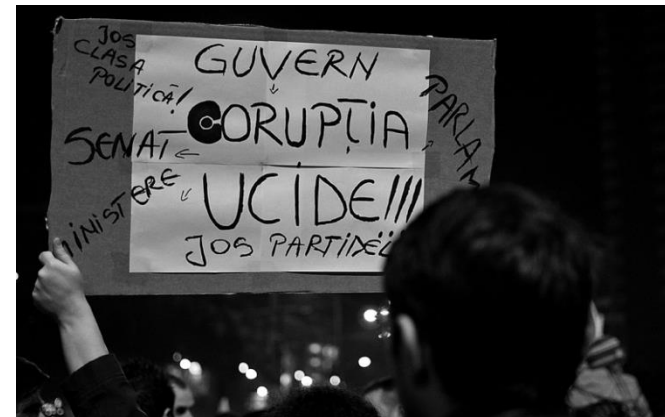
↓ -2 since 2020

Score changes 2012 - 2021



Romania

- Corruption considered as major problem
- Despite new laws to fight corruption, enforcement has been weak
- Corruption seen as part of business culture
- Country has seen regular anti-corruption protests



WESTERN EUROPE / EUROPEAN UNION

ROMANIA

Score

45/100 [What does the CPI score mean?](#)

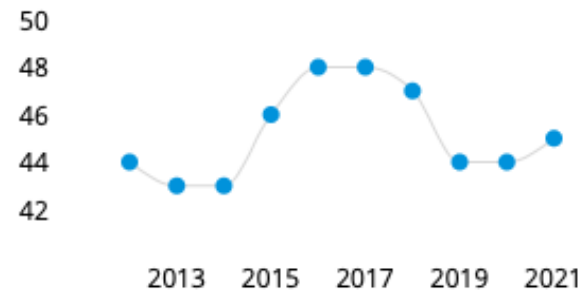
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66/180

Score change

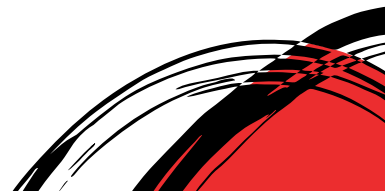
↑ **+1** since 2020

Score changes 2012 - 2021



The Devil's Circle

- Corruption is complex and multi-layered in transition economies such as Bulgaria and Romania
- ALL entrepreneurs are affected by corruption whether they accept it, embrace it or seek to avoid it
- A Bulgarian entrepreneur: *"We call it the devil's circle because you can never escape it."*
- The *devil's circle* envelopes business activity and has direct implications for growth aspirations and actions (Vorley and Williams, 2016)
- System of small scale gifts, large scale bribes



Key Findings

Key questions

Summary of key responses

To what extent does corruption impact on entrepreneurial activity?

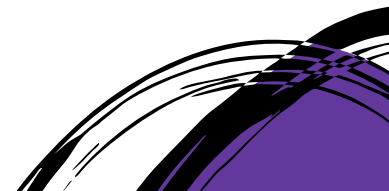
Corruption is commonplace and is a reality of entrepreneurial life
Entrepreneurs stated that they had sought to avoid corruption, while others said that they had to engage in corrupt practices in order to secure key contracts
Corruption is viewed as normal and somewhat accepted

What type(s) of corruption did you experience when you started your business?

There are systems of bribes to be paid to register a business and to get licenses. These are typically of low value and do not negatively impact the potential of the venture in terms of cost
The rules and regulations required to start a business create opportunities for government officials to engage in corrupt practices
Bribes and 'gifts' are paid to speed up the registration process

How did you respond to facing corruption at the start-up stage?

The payment of bribes is viewed as normal and is accepted by many as a small but manageable barrier to entry
While rules and regulations have in some ways improved, their bureaucratic nature has allowed corruption (albeit on a small scale) to remain



How does the type and nature of corruption change as an entrepreneurial venture grows?

The payment of bribes continues if they want to expand in terms of, for example, employment numbers, different license requirements, geographical location(s)

If a business grows large, unwanted attention from other entrepreneurs can be generated which can result in corrupt being imposed by another entrepreneur.

This type of corruption was found to be much more acute in Bulgaria

Other entrepreneurs can act to try to put successful competition out of business either through threats and bullying, offers to buy the business at a low price and having them closed down through the use of contacts within government

Such activities being imposed by criminal entrepreneurs can be a major impediment to growth and competitiveness

How have you responded to corruption as your business has grown?

Rules (e.g. with regard to wages and tax contributions) are sometimes ignored as they are overly bureaucratic and burdensome


Entrepreneurs can be pushed into informal activities due to the bureaucratic pressures associated with growth, for example, through under-reporting of wages or social security contributions

What are the risks associated with entrepreneurs undertaking informal/illegal activities?

There is little prospect of sanction for the average entrepreneur as so many engage in off-the-books activity

Sanctions are not seen as a genuine business risk as the entrepreneurs' informal activities are generally on a small scale

Sanctions are only seen as a real business risk for large-scale corruption, for example, organised crime



Corruption impacts wider culture

- Larger businesses pressured by other entrepreneurs
 - *“If you grow big or you give the impression that you could grow big, a tycoon is going to come along and take you over ... You will receive an offer you can’t really refuse.”*

What are the wider societal perceptions of entrepreneurship?

Bulgarian and Romanian society is generally sceptical of entrepreneurship
The perception exists that entrepreneurs are greedy or criminal
Perception is caused by legacy of socialism and high profile organised crime

How have societal perceptions of entrepreneurship changed since the transition to a market economy?

There has been relatively little change in both countries
While it has become easier to start a business in Bulgaria and Romania and more people are doing so, societal attitudes have not changed significantly

- Culture:
 - *“People assume we are all criminals, that we are just out to rip other people off ... Entrepreneurship is not respected or valued.”*



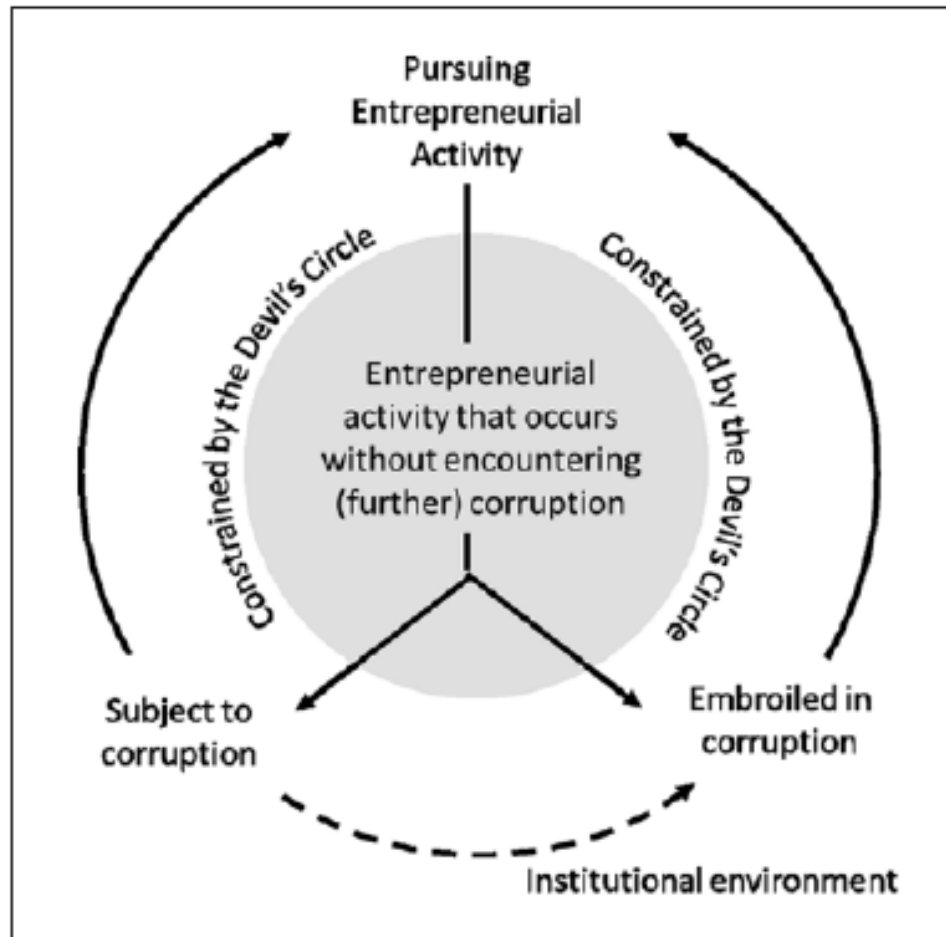


Figure 2. Dynamics of the devil's circle: curtailing entrepreneurial scale and perpetuating corruption.

Devil's Circle: Conclusions

- Economic transition in Central and Eastern European economies has centred on structural reform of regulatory institutions
- Given the weak enterprise culture (symptomatic of the centrally planned legacy) reforming formal institutions has not (yet) resulted in the emergence of significantly more enterprising economies
- Corruption has undermined the prevailing institutional arrangements and associated attempts to reform institutions intended to develop entrepreneurship
- The 'rules of the game' determine whether individuals elect to pursue entrepreneurial activity (Baumol, 1990), yet corruption serves to undermine these rules and this is detrimental to the enterprise culture
- While the business environments of countries such as Bulgaria and Romania are clearly problematic, change is possible as the institutional arrangements shift over time



Final Thoughts

- Corruption often occurs where institutions are weak – exploit poorly functioning governments; little prospect of sanction
- Transition economies provide good example of weak institutions and prevalent corruption
- As these economies have moved towards open markets, the role of informal and illicit activities has not receded and continues to impact on entrepreneurial activity
- Nature of corrupt activities are also influenced by the opportunities entrepreneurs are alert to
- Entrepreneurs harness resources to take advantage of opportunities
- Entrepreneurs can be both victims and perpetrators of corrupt activities
- Corruption impacts the entrepreneurial culture

