

# Barriers to entrepreneurship development in tajikistan



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## **Introduction**

The development of the entrepreneurship as an essential component of the economy of Tajikistan is taking place for the past 19 years, in spite of its certain downturn during the civil war in the country in 1991-1997. Within the given period, the legal framework for the regulation of business activities was developed and amendments to the particular conditions of the governmental policy related to the entrepreneurship support were made.

The stage of the entrepreneurship establishment required the improvement of its sectoral structure and enhancement of the economic efficiency. It is obvious that the prospects of its development are directly related to the alleviation of particular barriers which business people currently encounter. At the same time the inception of economical growth should initiate the positive influence on the entrepreneurship promotion.

The essay will exclusively focus on the analysis of entrepreneurship establishment and development in Tajikistan with the reference to SME sector including the importance of entrepreneurship for the socio-economic development. In addition, the essay will describe main barriers to entrepreneurship development and possible ways to alleviate the difficulties related to its promotion.

The rationale for the decision to write about this specific issue is based on following particular reasons: there are very few research works describing problems of entrepreneurship development in Tajikistan. Although, some scholars described these issues in the former Soviet Union countries, in most

of their works Tajikistan is only slightly mentioned among the other countries.

The objective of this given paper is to define the entrepreneurship situation in Tajikistan, the importance of its development as well as to identify the difficulties for entrepreneurship development and to provide recommendation for the solution of the existing problems.

In order to reach the stated objective, the following research questions were raised. First of all it is important to understand, what are the main barriers to entrepreneurship development in Tajikistan? Secondly, what are the possible ways to promote entrepreneurship development?

The theoretical and empirical grounds for the given paper are the analytical works of Tajik and foreign scholars, statistical data, as well as surveys and reports of various international institutions. Due to the analysis of both foreign and Tajik experts' assessments the reader will be enabled to find the dual opinion on the described issue.

## **Chapter One**

### **The role and importance of entrepreneurship in Tajikistan**

#### **1. 1 Tajikistan at a glance: background information**

In order to explain the entrepreneurship situation in Tajikistan, it is worth to describe the background information about the country.

Being a landlocked country, Tajikistan is located far from the main Eurasian highways. Infrastructure is poorly developed due to the fact that 93% of the all territory is mountains. In fact there are a number of scientific works <https://assignbuster.com/barriers-to-entrepreneurship-development-in-tajikistan/>

describing the linkages between the infrastructure and the country development, including development of the entrepreneurship. However, in the framework of present essay the impact of poor infrastructure to the entrepreneurship development will not be discussed.

During 1929 – 1991 Tajikistan was a member of the Soviet Union. After the breakdown of the Soviet Union in 1991, the country gained independence and started the transition to the market economy. After gaining its independence, the country was immediately faced with the economic problems caused by the collapse of the centrally-planned Soviet economy: such as, disruption of guaranteed markets, withdrawal of subsidies and instability of exchange (Middleton, 2007). Due to these facts, economical as well as political transformations of Tajikistan were difficult, primarily due to the holdover of various centrally planned “ command and control” approaches to the national development (Suhir, 2003).

According to Johnes, Tajikistan can be considered as the poorest of the countries of the former Soviet Union. At the beginning of its independence the position of the country was undermined by a civil war which lasted from 1991 until 1997. During that time the economy suffered significantly. In addition, the war has seriously disrupted the entire infrastructure of the country and contributed to the emigration of almost one million people, this number was equaled to a sixth of the total population. After the end of the civil war, the government undertook an aggressive program of reforms. As a consequence, by the beginning of 2000, the majority of small sized enterprises had been privatized, and most of the large enterprises were transformed into joint stock companies. Moreover, almost half of all cropland

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belonged to private people. In addition, being a neighbor of Afghanistan, the country has fallen victim of the drug trade and has been directly affected by drug-related criminal infiltration (Johnes, 2002).

Despite its growth, Tajik economy is not still fully recovered from the effects of the collapse of the Soviet Union and the civil war. The gross domestic product in 2007 was still only 72% of the 1991 level in real terms, which is visually represented in the Chart 1.

Chart 1: Real GDP continues to recover but has not reached the level of 1991

Source: Business Environment in Tajikistan as seen by Small and Medium Enterprises, IFC, 2009

## **1. 2 Definition and types of entrepreneurship in Tajikistan**

The process of society democratization and the implementation of market relations which are taking places in Tajikistan nowadays caused a variety of positive “ effects”. Entrepreneurship which influences all economical spheres can be considered as such effect. In developed countries the role and the importance of entrepreneurship are being evaluated quite high. “ Our country, which has chosen the path of market economy, is considering the issues of entrepreneurship and strengthening of its role as a matter of paramount importance” (Rahmon, 2001, own translation).

According to the State program of “ Protection and support of entrepreneurship in the Republic of Tajikistan” for the years 2002-2005, entrepreneurship is described as an activity which independently carried out by the persons registered in an order established by the law; this activity is

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directed to the earning of profit from use of property, sale of goods, manufacture, performance of works and rendering of services.

Entrepreneurship development is one of the priority directions of financial and economic policy in the conditions of market economy and it is directed on increase in production and rendering of services as well as provision of new workplaces” (Soliev, 2004). It is quite possible that the reason of such simplified definition of “ entrepreneurship” was to motivate as much as possible people to become entrepreneurs.

Tajik scholar Juraboev described entrepreneurship as “ a search for new spheres of rationalization and a profitable investment of recourses, performance of new combinations in manufacture, movement to the new markets, and creation of new products. It is aimed at making a profit above the average level” (Juraboev, 2003, own translation).

The tendency of entrepreneurship development in Tajikistan started from the period of 1993 – 1994. At that time the quantity of enterprises which performed entrepreneurial activity and had a status of legal entity was equaled to 3304 enterprises for the year of 1993 and 3988 enterprises in 1994 (Statistical yearbook , 2006). The entrepreneurship area was dominated by the cooperatives, farmers, private and individual enterprises.

However, the crisis in the economy caused by the severance of economic relations between the former Soviet Union countries which had common free market zone before, and the post-war factors with corresponding decrease of nation welfare became the reasons of reduction in the quantity of private enterprises, especially SMEs.

Nevertheless, in later years the entrepreneurship in Tajikistan, which for the purposes of this essay is described by the SME sector, started to recover from the consequences of Soviet Union breakup. The obvious development of SME sector can be proved by the available data that shows that in October 2006 the amount of small and medium enterprises in Tajikistan was equaled to 12167, including 7578 active enterprises. The structure of the SME sector can be described as follows: the highest amount of 38.4 % is commercial enterprises, the share of trade and catering – 17.2%, construction – 13.3 %, industry – 12.3%. The part of other economic activities is equals to 20% (Nazarov, 2006).

In addition to the information provided above it is important to identify the SME sector in Tajikistan. In compliance with the Law of the Republic of Tajikistan « On State Protection and Support of Entrepreneurship in the Republic of Tajikistan» passed in 2005, the SME sector is composed of three typologies of businesses. The first group is individual entrepreneurs, who is involved in a business activity without forming a legal entity and operate it at their own risk. The second group is dehkah farms – enterprises involved in the production and sale of agricultural products. Dehkan farmers operate as individual entrepreneurs according to the State Registration Certificate. Third group includes small and medium sized companies (Law “ On State Protection and Support of Entrepreneurship”, 2005, own translation).

Moreover, the special SMEs criteria are also being significant. As consistent with the Tax Code of Tajikistan, small enterprises are individual entrepreneurs and legal entities which perform business activity and their gross revenue (before taxes) is not exceed 150 000 USD. The average  
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quantity of employees should not exceed 50 for agricultural sector and 30 for other sectors. Respectively, medium enterprises are individual entrepreneurs and legal entities whose gross revenue is more than 150 000 USD but does not exceed 3.7 million USD. The average quantity of employees can vary from 50 to 200 for agricultural sector and from 30 to 100 for other sectors (Tax Code, 2009, own translation). In fact the Micro-enterprises are not defined in the Tax Code.

### **1.3 The importance of the entrepreneurship in the socio-economic development of the country**

Nowadays private enterprises are functioning almost in all fields and spheres of the economy of Tajikistan. With the presence of necessary support, the entrepreneurship plays an important role: it contributes to the state budget, creates new employment and stimulates the social and economic development of the regions. Furthermore, entrepreneurs play a significant role in the social and political life of society.

According to the statistics, in the year of 2007 approximately 1.7% or 19 thousand people of all population working in the private sector belonged to the SMEs. Over the last years, the quantity of employees of small and medium enterprises has increased by 14.5%, while the amount of enterprises has risen by 35%. However, the most interesting fact is that the total quantity of employees in the SME sector in 2007 was lower compare to the 1998 (Statistical Yearbook, 2008). Visually this information is presented in the Chart 2.

Chart 2: Dynamics of the quantity of employees in SMEs (in thousands)

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Source: Tajikistan: 15 Years of Independence. Statistical yearbook, Dushanbe, 2006

It can be assumed that the relatively low quantity of employees in the SME sector is resulted from the tax burden of the employers. In fact, the amount of social tax which the employers have to pay equals to 25% out of the total payroll fund. Moreover, in contrast to the other countries, the existing taxation system in Tajikistan does not have the tax remissions in connection with the increase of the quantity of workers (Nazarov, 2006).

Furthermore, the role of entrepreneurship in the market economy is very significant in terms of solving a number of socio-economic problems as well as in the poverty alleviation. Small and medium enterprises create the most favorable opportunities for the entrepreneurship especially at its initial stage. The presence of the substantial amount of SMEs on the market promotes the competition. And by promoting the competition, small and medium enterprises stimulate the increase of production efficiency as well as production growth which in its turn may cause the real growth of the economy.

As a short summary of the given section about the importance of entrepreneurship in general and SMEs in particular, it can be stated that it is both the aim and the tool for the development of market economy. The dual role of entrepreneurship is confirmed by the analysis of the functions of SMEs which were classified into two groups. These groups are objective functions and tool functions. The “ objective” functions promote the development of small and medium entrepreneurship and being considered

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as one of the governmental tasks. These functions include the impact on the unemployment reduction, the acceleration of the technological progress by means of innovations and ensuring the social and political stability in the society. According to the “ tool” functions, small and medium entrepreneurship is being used in order to limit the tendencies of monopolized economy, to support formation of a middle class and to fill the particular market “ niches” which are not attractive for the large enterprises (Chapek, 2004. own translation).

## **1. 4 Characteristics of entrepreneurship development in Tajikistan**

The establishment of entrepreneurship in Tajikistan started at the time when the legislative foundations were absent. The Law “ On entrepreneurship activity” was passed only in December 1991 and up to day it has completely changed. This law had a lot of disadvantages which negatively affected the process of entrepreneurship establishment in the country. Other economic laws which could support and secure the entrepreneurial activity in Tajikistan were passed later. For instance, “ The law on property” (1996), “ The law on privatization of state property” (1997) as well as laws related to taxation, customs and currency circulation (Nazarov, 2006).

The formation of the entrepreneurship took place at the period of destabilization of finances and significant level of unemployment, which were caused by the collapse of the centralized control system. Another unique feature of entrepreneurship formation and development in Tajikistan is the limitation of strategic behavior. There are two reasons explaining it.

First of all, during the first years of the market economy establishment, the <https://assignbuster.com/barriers-to-entrepreneurship-development-in-tajikistan/>

formation of entrepreneurship was influenced by the substantial advantages of short-term transactions in the sphere of circulation and in the financial market. This circumstance created an appropriate attitude, stereotypes of thinking and behaving. Secondly, there is a significant gap between the profitability of long-term investments in manufacture and short-term financial transactions. The conditions for the implementation of long-term investments projects in the production sphere are such that invested funds will be paid off only in 3-5 years; however, in conditions of the transition economy this process may take even longer. Therefore such areas of entrepreneurship as trade and catering remain the most attractive for the entrepreneurs (Soliev, 2004).

According to the statistics, at the beginning of 2008 there were 55, 8 thousands of enterprises registered in Tajikistan; in fact, 60% of them are private enterprises including both SMEs and large enterprises (Statistical Yearbook, 2008). There is a trend toward positive increase of total amount of enterprises in general as well as private enterprises in particular, as it is demonstrated in the Chart 3.

Chart 3: Dynamics of total amount of enterprises, including private enterprises (in thousands)

Source: Statistical Yearbook of the Republic of Tajikistan, Dushanbe, 2008

The dynamic development of SME sector is caused by several specific advantages of the latter. According to the Kamarov, the most important fact is that SMEs are able to get their own market share, although they have much less funds for implementation of important strategic researches  
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compare to large enterprises. In addition, small and medium businesses are quite flexible and mobile, which allow them to react fast for the market demand as well as to adapt for the changing conditions. Small entrepreneurship can be characterized as an originative type of economic behavior which at the same time being described as special entrepreneurial spirit and creative action (Kamarov, 2009).

Another important fact is that on every 1000 of economically active population in Tajikistan there is in average only one SME; in contrast, in Russia there are 3 enterprises on every 1000 of economically active population (Davgyalo, 2007).

## Chapter Two

### Barriers to entrepreneurship development

#### **2. 1 General overview of difficulties related to the entrepreneurship development in Tajikistan**

As it is demonstrated by the world experience, the more opportunities for the widening of the activity by the entrepreneurs, the higher growth rate can be seen for the country. Under the given circumstances, the creation of the favorable conditions for the entrepreneurship development is a crucial factor.

The entrepreneurship of Tajikistan faces particular barriers, among the others they are: instability and imperfection of the legislative system related to entrepreneurship, high level of taxes, complexity of tax collection, insufficiency of the start-up capital and current capital, difficulties with the

access to bank loans, corruption, shortage of the qualified staff, difficulties with the rent of the production space as and others. In most cases there is no proper social and personal security for owners and employees of the private enterprises (Soliev, 2004).

The current institutional mechanism of entrepreneurship promotion demonstrates that although the entrepreneur is secured by the laws and governmental instruments, the level of entrepreneurship development is not correspond to the high taxation level and crediting rates. (Asrorov et al., 2004). Therefore the entrepreneurs are acting in the environment of legal and economical limitation.

The barriers faced by entrepreneurs impede the inflow of billions of dollars of potential profit for the country each year and threaten to derail the political and economic transition. These losses take place due to the ill-designed, complicated laws and regulations that unnecessarily raise the cost of doing business in the formal sector. As a result of high costs of doing business, entrepreneurs are using in their operations limited funds in order to survive with presence of low income and consequently they are losing the economic potential. In addition, the costly business regulations encourage potential investors to invest in the more favorable business environments and therefore country faces the lack of the needed investments (Suhir, 2003).

The experience of entrepreneurship establishment and development in Tajikistan demonstrates that the majority of business owners are not aimed at the further growth. Their main goal is to ensure the stable existence, to preserve their capital and market position (Urdashev, 2005). The given

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situation can be explained by two reasons. First of all, there is no effective system for the stimulation of entrepreneurial activity. Secondly, entrepreneurs are experiencing the certain pressure from the tax, custom and law-enforcement authorities.

## **2. 2 Main barriers faced by entrepreneurship in Tajikistan**

In this section of the paper the main barriers to the entrepreneurship development will be described in details. These barriers are: difficulties related to licensing, access to finance, imperfection of taxation system, poor infrastructure, corruption and lack of sufficient knowledge by entrepreneurs.

### **Licensing**

IFC defined license as “ a special permit issued by a state body authorizing a business to carry out a certain activity under specific terms and conditions. When a business is subject to licensing requirements, it must obtain the specific license before starting its activities. Thus licensing happens after business registration, but before a company is allowed to start operations in the activity to be licensed” (IFC, 2009).

The barriers related to the licensing can be classified as the continuation of the Soviet “ system of permissions” whereby one must obtain approval from the authorities in order to perform even the smallest tasks. The present “ permissive” entrepreneurial climate which characterized by abundant regulation, continues to inflict losses on entrepreneurial activity in all sectors of the economy (Suhir, 2003).

According to the world practice, the low-risk activities and those which do not involve any limited resources should not be subject to licensing. In fact, Tajikistan licenses some activities that are not licensed in many other countries; for instance, real estate valuation and tourism (IFC, 2009). The Chart 4 illustrates that in spite of the recent reforms, the number of activities licensed in Tajikistan is still relatively high compare to some other countries.

Chart 4 Number of economic activities subject to licensing in selected countries

Source: Business Environment in Tajikistan as seen by Small and Medium Enterprises, IFC, 2009

For instance, IFC reports that eight of the 65 licensed economic activities are related to the transport. However, the implementing regulations of the Licensing Law's divide these eight economic activities into 22 sub-activities, each of that in its turn requires a separate license.

In addition, the period of validity of licenses as well as their cost still remains a problem. The law foresees that the minimum period of validity for the license is 3 years; however, on practice the licenses are being issued for the period which in average is less than one year (IFC, 2009). The short periods of licenses validity impede the investments and long-term development as well as create the grounds for the extortion by the officials.

## **Access to finance**

One of the main conditions of the entrepreneurship development is the existence of proper financial infrastructure. In general the Tajik financial

system was growing rapidly over the past years, although it still remains small. Recent data shows, that there are twelve commercial banks (including one state-owned bank), seven credit societies, one non-bank financial institution and eighty eight microfinance institutions operating in Tajikistan (IFC, 2009).

The banking systems in Central Asia in general and in Tajikistan in particular can be considered as insufficient since they impose impossible demands on entrepreneurs due to the unreasonable time-frames and terms of credit repayments, it is difficult to provide collateral and to find a guarantor for securing a loan (Suhir, 2003). Thus in order to get a loan from some commercial banks the entrepreneur should provide the collateral which values up to 3 times more compare to the actual amount of requested loan. The survey performed by the IFC demonstrates that more than half of rejected loan applications in 2007 were due to the insufficient loan collateral (IFC, 2009). In addition, the process to formalization and registration of the collateral is complicated and expensive at the present time.

Besides that, the loans themselves became not very attractive because of the interest rate. Additional factor of distrust to the banking area is the lack of reliable mechanism for the protection of the borrower's interests. In this respect the majority of entrepreneurs actually not able to use services of commercial banks.

The Chart 5 demonstrates what kind of problems entrepreneurs encounter in terms of access to the finance. And it is quite clear that the most important issue is high interest rates.



## Chart 5: Main obstacles as identified by the potential borrowers (in %)

Source: Business Environment in Tajikistan as seen by Small and Medium Enterprises, IFC, 2009

In general, in compliance with the “ Doing business” report, Tajikistan is ranked as 167th overall in terms of easiness to getting credit (World Bank, 2010). And firms consistently rate access to credit as among the greatest barriers to their operation and growth.

## **Taxation system**

The modern tendency for the entrepreneurship development can be described as the one with the lack of unity of economic aims between entrepreneurship and government. On the one hand, the governmental regulations related to the entrepreneurial activity are grounded on the creation of the favorable conditions for the entrepreneurship development; however, on the other hand, they are directed on provision the maximum tax revenues to the state budget. At present there are 18 different taxes in Tajikistan. According to the statistics, forty-eight percent of country’s tax revenues in 2008 came from the value-added tax. Tax code states that the value-added tax is equal to 18%, income tax – 30% and social tax – 25% (Tax Code, 2009). Such level of taxation does not correspond with the taxation systems used in developed countries. As a rule, developed countries increase tax rates in order to restrain the overproduction (Davgyalo, 2007). In fact there is no problem of overproduction in Tajikistan.

On the whole the tax regime in Tajikistan is characterized by high complexity and instability. The Tajik Tax Code, which went into effect in 2004, has been <https://assignbuster.com/barriers-to-entrepreneurship-development-in-tajikistan/>

amended 9 times since that time. Unfortunately given amendments neither caused the simplification of tax obligations nor improved tax administration. The World Bank Group's "Doing Business 2009" report demonstrates evidence that taxes impose a heavy burden on business taxpayers in the country. This report ranks Tajikistan as 159th out of 181 countries in terms of ease of complying with the tax obligations (World Bank, 2009).

Besides, the procedure of preparation the tax forms is complicated, the average Dehkan farmer or individual entrepreneur has spent almost 5 working days on the filing and on payment of taxes in 2007. While the average SME spent more than three weeks on this process. Moreover, there is a lack of effective communication infrastructure for the acceptance of the tax reports by mail. Although the Tax Code states that it is possible for taxpayers to submit their tax declarations in three ways: by certified mail, in person, or electronically; in practice, entrepreneurs submit tax reports in person. In addition, the survey performed by IFC shows that that submission of tax declarations involves a significant period of time spent waiting in lines at the tax office in order to get the appropriate signatures (IFC, 2009).

## **Corruption**

The harmful nature of corruption between government and business enterprises is a classic conflict of the political economy, which goes back to Adam Smith's *The Wealth of Nations*. In the socialist period, bribery was widely practiced as a sort of necessary evil among citizens in Soviet Union Countries. It operated as a special social mechanism used to overcome obstacles established by bureaucratic systems as well as chronic shortages of supply which could affect business operations and everyday activities. In <https://assignbuster.com/barriers-to-entrepreneurship-development-in-tajikistan/>

contrast, in the transition period, the corruption between entrepreneurs and bureaucrats started to take place more for self-interest rather than as a socially necessary evil like it was in Soviet Union time (Ichiro Iwasaki, 2007).

Interesting explanation of the existence of corruption was provided by Clark and Naito in their article. According to them, corruption is endemic in all countries of Central Asia. However, the additional factor which contributes to the level of corruption results from the existing barriers with respect to the cooperation between various Ministries. In fact, nowadays the level of cooperation is relatively small and as a consequence there is a shortage of transparency in the system. The lack of transparency in its turn allows corruption to flourish as there are no checks and bounds on the system (Clark, Naito, 1998).

The number of surveys performed by the World Bank confirms the fact that corruption remains a main constraint for entrepreneurship in Tajikistan. This demonstrated by the high frequency of informal gifts requested from enterprises by the government officials, so called Graft Index. The Graft Index shows the proportion of instances in which enterprises were either requested or expected to pay an informal payment for licenses, permits or public services (IFC, 2009). Visually the situation with corruption in Tajikistan in comparison with some other countries of Eastern Europe and Central Asia is presented at the Chart 6.

Chart 6: Tajikistan has the highest graft index in Europe and Central Asia (ECA)

ECA Regional Average

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Source: Business Environment in Tajikistan as seen by Small and Medium Enterprises, IFC, 2009

However, the survey performed by IFC in 2007 demonstrates that the situation related to the informal payments in Tajikistan has improved over the last years. According to the survey responses, entrepreneurs were asked for or expected to pay bribes or give informal gifts in 2007 fewer compare to previous years. Although this is a positive development, it is too early to conclude that corruption is no longer a problem. Data demonstrate that 21% of enterprises have defined the informal payments as a main obstacle for their business activity. In fact, only high tax rates were defined as a major obstacle more often than corruption (IFC, 2009).

### **Lack of the sufficient knowledge by entrepreneurs**

Johnes stated that the main resource which is available to Tajikistan is its people. Generally the level of education in the country is high, with a literacy rate about 98% (Johnes, 2002). However, one of the obstacles which may be additionally observed in Tajikistan nowadays is the lack of the sufficient knowledge in the area of entrepreneurship.

This fact can be explained by taking a look at the history. In the Soviet era entrepreneurship was considered as a “ speculation”. The Great Soviet Encyclopedia defines “ speculation” as a process of buying up the goods on closed markets and resale those goods on open and deficiency markets in conditions of constraining the freedom of trade, for example, during the war (Great Soviet Encyclopedia, 1978, own translation). This activity was punishable either by high fines or imprisonment and due to this reason was

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considered as a part of the shadow economy. Based on the above mentioned information, the following conclusion can be drawn – the entrepreneurship as an activity as well as entrepreneurs are still being considered as unacceptable or even discreditable activity by the people of older generation.

It is obvious that problems related to managerial issues are really crucial for the private entrepreneur due to the reason that the manager should be a specialist with a broad knowledge in the area of management, finance, accounting and marketing. In fact, nowadays the universities of the country are not preparing such versatile managers for the private sector (Urdashev, 2005).

The current situation in Tajikistan is such that the majority of entrepreneurs have problems due to the lack of proper knowledge. Thus according to the IFC survey, more than one-third of individual entrepreneurs did not keep any financial or tax records in 2007 (IFC, 2009), despite the existing requirements. The responses presented in the Chart 7 demonstrate the reasons for the absence of necessary records. It is clear that the lack of knowledge is a very significant issue in this respect.

Chart 7: Reasons f