

# Global Entrepreneurs Enabler Index

## GEEIndex

### A Government-Rating Tool

The Global Entrepreneurs Enabler Index (**GEEIndex**) starts with the belief that the well-spring of entrepreneurship in societies is found in self-employed individuals who usually constitute 15-25 per cent of developed economies' workforces. The GEEIndex measures the impact of laws and regulations on the ability of individuals to be self-employed and hence entrepreneurial.

## Concepts and Methodology Paper

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[Full details of the GEEIndex may be found at [www.geeindex.com](http://www.geeindex.com)]



### GEEIndex developer

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# Global Entrepreneurs Enabler Index

## A government-rating tool

### Part One: CONCEPTS

#### Summary

Currently, government laws and regulation are not assessed from the perspective of their impact on self-employed people. Yet the impact is direct and profound on the capacity of self-employed people to exist as entrepreneurial players in societies. This Index applies measures for assessing this.

#### Overview

The Global Entrepreneurs Enabler Index (GEEIndex) applies standard measures and a rating against which the policies and laws of countries and regions can be assessed in terms of the extent to which they enable entrepreneurship to happen or suppress entrepreneurship or make it more difficult.

Called the Global Entrepreneurs Enabler Index (GEEI), this is an indicator and tool for jurisdictions to review policies with the aim of enabling entrepreneurship.

Since the late 1930s, economists have subscribed to a general thesis that economic development occurs through innovation and that innovation is the result of business activity by society's entrepreneurs. This thesis has become an important part of economists' and governments' understanding of economic development. The consequence is that if societies want economic development, they need to encourage their entrepreneurs.

Normally, entrepreneurs are thought of as being relatively rare individuals who, against all odds, create large business enterprises driving new, often attention-grabbing ways of doing business. This is true. Entrepreneurs often do create large enterprises.

This Index, however, takes the idea of entrepreneurship to its most basic level by asserting that the heartbeat of entrepreneurship in societies resides with self-employed individuals. Entrepreneurship, we assert, is in fact a common and normal attribute shared by all humans and therefore not at all rare.

Entrepreneurial capacity resides in every person. The question is not whether the entrepreneurial spirit exists, but whether a society's institutional structures and rules allow entrepreneurship to flourish. Entrepreneurship most commonly happens, we say, when an individual is self-employed. That is not to say that self-employed people are always entrepreneurial. But without entrepreneurship, business success and hence self-employment is problematic.

The Index applies ratings against government policies in terms of whether they encourage or diminish the capacity to be self-employed and hence enable entrepreneurship.

This introductory section discusses the key concepts behind the Index.

## **The conceptual framework of entrepreneurship applied in this Index**

The Index enables measures to be applied to government regulations, policies and practices assessing how those affect individuals' capacities to find and express their entrepreneurial desires. The Index is specific looking at the details of government regulations, policies and practices. In this way the Index becomes a tool. It can measure the impact of government on entrepreneurship and identify specific changes to government regulations, policies and practices that can enhance and enable entrepreneurship or suppress it.

The Index doesn't, nor does it attempt to, measure other factors that affect the entrepreneurial expression of individuals in societies. For example, the Index does not attempt to measure cultural factors. That is, the culture of any given society heavily impacts on the willingness of individuals to be entrepreneurial. The assessment of this is beyond the intent and reach of this Index.

Instead, by focusing on government laws and regulations the Index can, in a reasonably objective manner, create comparative ratings and assessments.

The Index focuses on two primary aspects of government laws and regulations in terms of how they affect the individual entrepreneurship capacity of self-employed people or people who desire to be self-employed. These are (a) the extent to which individuals are allowed to be self-employed as opposed to being forced to be employees and includes, for example, the ease of business registration, tax rules and so on, and (b) the extent to which laws and practices around commercial contract transactions enable self-employed individuals to have measures of equal rights under contract, as against large businesses and government.

The rationale behind each of these measures is explained below.

## **The conceptual structure of 'business' applied in this Index and its relationship to entrepreneurship, innovation and economic development**

In a broad sense the idea of an individual being an 'entrepreneur' is tied to the idea of 'business'. An entrepreneur is someone who takes an idea, concept or invention and through business activity takes that 'thing' into a market. If an invention, for example, is not translated into a product that people buy and use, it has not been transformed into an innovation. It is the business process that does the transformation. It is entrepreneurs that guide and give direction to the process.

To understand an entrepreneur and innovation it's helpful to have a structural understanding of what a business is. This Index applies a three-step process to understanding that.

First, the Index starts with the basic idea that an individual can be a business—that is, a 'business of one'. This is the self-employed individual.

The second phase is where the individual employs or engages other individuals to help them in their business but the business essentially remains the product of the originating individual.

The third stage is where the business takes on a size where the management of it is larger than the originating individual can handle. The business by necessity becomes a management system that is bigger than the capacities and personalities of the originating individual, even if that individual retains a heavy influence.

Within public policy settings and research the focus on entrepreneurship and innovation probably and traditionally concentrates on the third stage. This Index however is interested in the first two stages. Stage two is probably easily recognised as 'small business' and stage

one tagged as self-employment, independent contracting, consulting, micro-business, freelancing and many other similar and related terms.

The assumption underpinning this Index is that entrepreneurship and innovation will most likely and most commonly be born through stages one and two. Stage three is where entrepreneurship and innovation is developed, consolidated and enhanced and yes, can also be reborn—although we contend with more difficulty than in stages one and two.

Our concentration on stages one and two is because the act of being self-employed, even if this involves employing others, of its essence requires the individual to be entrepreneurial in order to succeed. We assert this on the following basis. The self-employed person is entirely a risk taker. Such people are not protected from the market (as employees are). Their income from their business is exclusively dependent on the whims and fancies of the market/s within which they operate—that is, their clients. If they don't satisfy the needs of their clients, their income will quickly diminish or stop. They will then cease to be a business because a business does not exist without income. It follows that the consequence of being self-employed demands an obsessive client focus. It demands being entrepreneurial—assuming, that is, that the individual is genuinely self-employed. We contend that the behavioural essence of entrepreneurship is this client focus.

It is this profound characteristic of self-employed people that warrants attention and to which this Index looks. There is global significance, we believe, for economic growth potential in all economies, because of the sheer scale of entrepreneurship that can be brought to economies by self-employed people.

Self-employment in all societies is significant and large in numbers. Research indicates, for example, that in the major developed economies (non-agricultural) self-employment falls into a band of between 15 to 25 per cent of workforces.<sup>1</sup> That is, it can be argued that up to a quarter of any given community's workforce is potentially behaving within an entrepreneurial framework. If this is accepted, even partly and with qualifications, it follows that encouragement of self-employment should aid economic development and should be important as a government policy objective. It's on this basis and this assumption that this Index operates.

## **Measurement 1: Why the difference between employment and self-employment is an entrepreneurial indicator**

The first major theme the Index studies is the extent to which laws, rules and regulations make it difficult or prevent individuals from becoming self-employed. If it is complex to become or remain self-employed the realisation of entrepreneurial capacity in a society is constrained. The reasons behind this contention are as follows.

Work in societies is mostly structured and organised through employment. Employment is a highly specific legal and managerial status. In both its legalities and managerial application employment involves a 'boss', an employer, organising employees to perform functions at the employer's direction. In businesses that operate using employment, and that is most particularly the case with large businesses, entrepreneurial activity is restricted by design to the activities of the employer. The entrepreneur in the business is the employer. The employee's primary function is to be an enabler of the entrepreneurial employer's wishes, not to be entrepreneurs themselves. This does not mean that employees cannot be entrepreneurs in some way but it's only possible if the employer approves. Any discretion the employee may be able to exercise to be entrepreneurial is only allowable within the parameters set by the employer.

With self-employment it's completely different. Self-employment is an escape from being employed. Self-employment by its nature forces the individual into risk taking. There is

no income security umbrella of the firm because they are the firm. They are subject to the vagaries of the market/s within which they operate. To not innovate as a self-employed person is to cause your business to decline and ultimately to put yourself out of business.

But the entrepreneurial activities of the self-employed person are mostly small and unspectacular, and in some ways 'ordinary'. Quite often it is said that a small business person can be running a business but not be entrepreneurial. This Index does not operate from that proposition. Rather, the Index asserts that the fact of being self-employed requires entrepreneurship, otherwise business failure occurs which results in the collapse of self-employment. This can be demonstrated by an example.

Take a basic business, say someone who runs a street fruit-selling stall in a financial district in a major city. The potential client base is drawn from the thousands of office staff who walk past the stall daily and who may buy an apple for lunch or a small bag of fruit at most. If the person operating the stall is an employee of the stall owner, their income will most likely be set on a fixed hourly or weekly basis. Their income is not tied to the financial success or otherwise of the stall. The employee's behaviour is dictated by the price signals they receive, namely a set wage. Consequently it's more likely that they will mostly stand by the stall waiting for customers to approach, hand over the fruit and take the money. They may have a 'personality', be engaging with customers and do a good job. But their price signal motivations won't be essentially entrepreneurial.

Compare that with the case where the owner of the fruit stall is a self-employed person. Their income is entirely dependent on the volume and price of fruit they sell less the costs they have in running the stall. To the casual observer there may be little apparent difference in being served by the owner as opposed to the employee. But the owner, has no choice (assuming business success is the goal) but to be constantly entrepreneurial and in thousands of small ways. This includes ensuring the fruit on offer is of high quality, observing what people buy and don't buy, changing the mixture of produce accordingly, creating specials based on fruit in season, paying attention to the positioning of the stall on the street so it attracts the eye of passing potential customers and so on. The list of questions and issues the business owner must deal with are seemingly endless and require constant consideration and fine-tuning. One issue addressed one way one day may need to be addressed differently the following day.

To some, these activities of the fruit stall owner may not seem to be entrepreneurial at all and rather just the normal things that are done in running a business. But this is a misconceived view. The essence of being a business requires and demands a constant switching of the brain into an entrepreneurial mode focused on clients. The 'fear' of the market (clients) causes the human entrepreneurial DNA to kick in. If our fruit stall owner allows the quality of the fruit to drop, customers will stop buying. The 'art' of buying suitable fruit is an entrepreneurial exercise. And it's through this process that innovation may happen. Innovation is not guaranteed but entrepreneurship activity is.

This is how economic development through entrepreneurship and innovation mostly happens. It's the process of creative destruction that happens in markets. One person does something better and another person responds by doing something better still. And it mostly happens at the 'small end of town.' It's the millions of little things happening all day, every day that few people even recognise, and even fewer would think are of interest or importance. But the cumulative effect of millions of people doing this in millions of different ways is the big driver of economic development. It is vastly more significant in its impact because of the cumulative effect as compared to the small numbers of big innovations that attract big attention.

Can employees innovate? Yes. But as mentioned before, only within the authority granted to them by their employer. The fruit stall owner may have an employee that is paid a bonus based on sales turnover. This should cause the employee to be more client

(entrepreneurial) focused. This is smart management on the part of the fruit stall owner, but it's still the inducing of entrepreneurial behaviour within the authority limits granted by the employer, who is self-employed.

This discussion above sets the scene within which the first measure of entrepreneurship potential is considered in this Index. The question is, to what extent do government laws, regulations, policies and practices enable individuals to be self-employed or restrict and even stop self-employment? This can be measured.

## **Measurement 2: The commercial contract and its connection to entrepreneurship**

The second major Index measurement looks at the extent to which commercial contract laws and the application of those laws enable self-employed people to have effective control of the commercial contracts upon which they rely for their business activity. If self-employed people have little or no effective control of the contracts into which they enter, their capacity to conduct business and be entrepreneurial is constrained or even neutered. They may in fact be forced out of business.

The reasons for this are related to the management of commercial risk. The extent to which risk can be managed by self-employed people, heavily impacts on their capacity to be entrepreneurial.

There are two primary ways of measuring this as it impacts on self-employed people. The first is to look at the structure of the commercial contract as opposed to the content of it. The second is to consider the ability to effect quick and cheap dispute resolution under contract. Both of these items impact in a very real way on the ability and willingness of self-employed people to engage in business.

The structure of a commercial contract is at law quite clear. Conceptually, for a commercial contract to actually be accepted as a contract it must have certain features. One of those features is that each of the parties to the contract has equal rights to 'control' the terms of the contract. For example, if a contract has a term that enables one party to change the terms of the contract without reference or approval from the other party, the 'contract' is not a true contract. Many lawyers dispute this. They say that a commercial contract is exclusively a product of 'offer and acceptance'. This Index rejects that proposition on conceptual and practical grounds.

When two large organizations enter a contract—say, a government department and a large firm—the two organizations will ordinarily spend considerable time and money on lawyers assessing, debating, negotiating and redrafting the contract. When the contract is finally signed it can be safely said that the trigger of 'offer and acceptance' between the two parties occurred with the full knowledge and consent of the two parties. However take a different scenario, that involving a large government department and a self-employed individual.

If the government department has a standard form contract that they use when engaging, say information technology specialists, and that contract enables the department to change the scope of the work without approval from an IT consultant, is it a genuine contract, even if a consultant accepts the contract?

This is what we refer to as the 'structure' of the commercial contract as opposed to the content. And there are examples where laws have been created to ensure that this commercial contract structure is required. Most examples occur under consumer protection law, usually under the tag of 'fair contract' law.

The second area of measurement is the capacity of self-employed people to enforce or have contract disputes resolved quickly and cheaply. If an individual cannot enforce a contract or have a dispute resolved quickly and cheaply, this increases the commercial risk under contract. Unfortunately it is all too common that for a self-employed person to fix a contract problem the legal expense and time required far outweighs the value of the contract work itself. Where this occurs it makes more commercial sense to suffer a loss. Thus commercial risk is increased because although the law may allow for contracts to be enforced, the practice of the law makes it too expensive to do so.

This has been recognised particularly under consumer law. Consumer protection laws frequently provide comparatively cheap and quick consumer dispute-resolution processes. This is done to 'protect consumers' but the real broader benefit is to increase the level of trust that consumers have in their purchasing decisions. The more trust consumers feel toward the commercial transactions they undertake, the more likely they are to undertake those transactions.

So to it is with self-employed people who are in fact in a very consumer-like position when engaging in business. Self-employed people have limited practical capacity to enforce contracts or affect dispute resolution if the processes of the law are drawn out and/or expensive. Like consumers, people are less inclined to be self-employed, or if self-employed become limited in their preparedness to take (sensible and considered) commercial risks, to be entrepreneurial and to innovate. The consequence is a diminution of the economic development potential that resides within a community through self-employed people.

### **A note on small business finance**

Across the globe, small business people struggle to obtain business finance. When they do obtain finance, they normally find that they are hit with higher interest rates than other businesses or individuals and onerous financial security requirements. The usual reason for this is that small business people are assessed as perhaps the riskiest borrowers in the community. A major reason for the higher risk profile is that small business people effectively suffer from discrimination, as outlined in this discussion. It should follow that if governments change the discriminatory regulatory regimes, thus reducing the systemic discrimination against small business people, the small business risk profile should drop. This should ultimately result in better and easier finance availability for small business people.

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## **Part Two: GLOBAL CHANGE**

### **Understanding this Index within the broader global change environment and academic discussions on entrepreneurship**

Why the GEEIndex and why now?

From somewhere around the late 1970s profound change began occurring in the nature and structure of work. The steady emergence of self-employed people developed to the point where self-employed individuals now constitute a major portion of workforces and this is likely to continue to grow. It's a development that must be understood. This section considers some of the academic discussions about what's going on.

## A change of paradigm: from ‘managed’ to ‘entrepreneurial’

The economist David Audretsch and his collaborators explored the difference between what they call the *entrepreneurial economy* and the *managed economy* that preceded it. According to them ‘the *managed economy* is defined as an economy where economic performance is positively related to firm size, scale economies and routinized production. In contrast, the *entrepreneurial economy* is defined as ‘an economy where economic performance is related to distributed innovation and the emergence and growth of innovative ventures’.<sup>2</sup>

They suggest that, during the first three decades after the turmoil of the second world war, the ‘managed’ economy seemed to be performing very well, ‘providing the engine for jobs, growth, stability and security’<sup>3</sup> as it ‘seemed that all countries were converging towards economies dominated by a handful of powerful enterprises, constrained only by the countervailing powers of the state and workers’.<sup>4</sup> However, they suggest, two main factors then triggered the emergence of the entrepreneurial economy: globalisation and information and communications technology (ICT).

But note the phrase: ‘constrained only by the countervailing powers of the state and workers’ (or, as Galbraith suggested, ‘big business’ balanced by ‘big labor’ and ‘big government’<sup>5</sup>). Although it is clear to many people that we are no longer in what Audretsch et al. call the managed economy, is some of our thinking still based on it? For instance, are many of the employment laws enacted by states and many of the policies promoted by unions still based on the assumption that they are dealing primarily with big business?

Further, according to Audretsch et al.:

The impact of technological change and its many moderators on entrepreneurship is so complex and pervasive that the policy implications are beyond those of just creating entrepreneurship policy next to the existing avenues of policies. The ascendance of entrepreneurship policy, with its focus on promoting new firms and small firms, was certainly consistent with the characterization that the entrepreneurial economy had superseded the managed economy. However, identification of the factors underlying why this shift actually occurred leads to a rethinking of the policy conclusion. Rather than a narrow focus on promoting new firms and small firms, the appropriate response of public policy should be to re-think the policy approach in a broad and pervasive sense, so that the focus is not on developing entrepreneurship policy, but rather policy for the entrepreneurial economy.<sup>6</sup>

According to Peter Urwin, the distinction between employment and self-employment only arose at the beginning of the 20<sup>th</sup> Century:

Developments in working arrangements that led to the modern-day distinction between ‘employees’ and the ‘self-employed’ can be traced back to the advent of industrial relations at the start of the twentieth century. Before this, in the early years of the Industrial Revolution, those supplying labour (as opposed to capitalists and landowners) were essentially self-employed. They had few of the benefits and security of contract that we associate with modern employees. Similarly, while employers held the balance of power in these years before widespread unionisation, workers did not systematically provide, for instance, fixed periods of notice. This relationship between business owners and workers was essentially the same as that which had prevailed for itinerant workers since antiquity.<sup>7</sup>

Urwin suggests that the distinction arose because big business wanted to have more control over its labour force because efficient industrialised production required a high degree of worker co-ordination—which is a managed economy requirement. Therefore, contracts of employment were introduced, instead of contracts of service (ie, the commercial contract applied to work situations). However, the implication of Audretsch et al.’s suggestion that big business was ‘constrained only by the countervailing powers of the state and

workers' is that the state and the unions, in their different ways, have required these contracts to include things such as minimum periods of notice, paid holidays and sick pay. In other words, a good deal of employment legislation and union policy is based on the assumption that big business is the norm, and the basis of economic strength, but that this needs reasonable constraint. In that way it is still based on an assumption appropriate to the 'managed economy'.

However, it would seem to be clear that we are now in a different paradigm—which Audretsch et al. have called the entrepreneurial economy (and which earlier Alvin Toffler had called the Third Wave because it came after the first two waves of the agricultural and then the industrial revolutions.<sup>8</sup>) In this situation there are different influences, opportunities and requirements and, it has been suggested, the distinction between employment and self-employment is starting to disappear again. Bigger business has shrunk to a core—buying in services such as computer maintenance, and marketing, which they used to have as in-house departments. In a similar way, smaller businesses only need the part-time services of some experts—so they prefer to buy those in as and when they are needed, rather than having them on the pay-roll full-time. It all helps them to be more flexible and more competitive.

Therefore, in line with the views of Audretsch et al., instead of trying to build on the entrepreneurship economy by entrepreneurship policies to encourage and assist more people to be entrepreneurs, instead it would be better to have a 'policy for the entrepreneurial economy'. This requires a reassessment of things such as employment legislation to assess how much is based on out-dated assumptions and change it to make it more supportive of entrepreneurial businesses. Thus, scoring entrepreneurship enabling policy should look broadly at 'policy for an entrepreneurial economy'. This is the aim of the GEEIndex.

### **Self-employment: Is it always entrepreneurial?**

This Index operates with a basic assumption that the heartbeat of entrepreneurship in any society resides with self-employed people. However there is considerable academic debate concerning the claim that being self-employed does not necessarily mean that an individual is entrepreneurial. That debate is recognised.

Peter Urwin has some useful observations on this. According to the early 18<sup>th</sup> century economist Cantillon, shop-keepers were entrepreneurs (being neither land-owners nor waged employees)—but today many people would maintain that someone who took over the shop his or her parents had run, and continued to run it in the same way, was entrepreneurial. The shop might eventually go out of business if the shop-keeper was not entrepreneurial and there was no innovation—but that does not mean innovation is obligatory. Many businesses do go out of business because they are not entrepreneurial.

As Urwin indicates, the division between the employed and the self-employed is a grey area. Big business employed lots of people—even having accountants and lawyers in-house—but many businesses continued to buy in the services of such professionals—who remained self-employed. Now many businesses are out-sourcing and it has even been suggested that employment as a distinct category may disappear again. Personal services such as window cleaning, where there are no economies of scale, have remained domains of self-employment, but again few think of them as entrepreneurs. Thus, when employment became a separate category, it was an accident of the type of work in which people were engaged that determined whether some people became employees and some remained self-employed.

## A note on productive, unproductive or destructive entrepreneurship

The GEEIndex takes the view that entrepreneurship through self-employed people is a desirable social and economic activity. However, is entrepreneurship always desirable?

Baumol presents a view of entrepreneurship that is not limited to business situations. In this broader view, entrepreneurship can be productive, unproductive or destructive. His basic hypothesis is that the magnitude of productive contribution of entrepreneurs to society varies less because of the total supply of entrepreneurs than it does from the way that the available entrepreneurship is applied to productive, unproductive or destructive uses. By looking at historical evidence from ancient Rome, early China, the Middle Ages and Renaissance Europe, he shows that the role entrepreneurs play is influenced by the rules of the society in which they operate. In ancient Rome, he suggests, 'people of honourable status had three primary and acceptable sources of income: landholding, usury and political payments'. Productive commerce and industry could generate wealth but not prestige, so those who wanted prestige directed their entrepreneurship to the acceptable applications which helped the individual concerned but were unproductive for society as a whole. In early China the rules did not favour productive entrepreneurship either and instead accorded supreme prestige to high positions in the state bureaucracy, thereby encouraging the application of entrepreneurship to unproductive activity. In England in the early Middle Ages the institution of primogeniture meant that often the only opportunity for the younger sons of barons lay in warfare, with the result that their entrepreneurship became destructive. Under all these systems, entrepreneurship was not necessarily lacking but was often directed by social norms and habits to unproductive or destructive applications. However, in situations like that in England at the time of the Industrial Revolution, when the rules had changed to allow those who engaged productively in industry to accumulate, not just wealth, but also respect and influence, the application of entrepreneurship to productive purposes was encouraged and the economy and society as a whole benefited.<sup>9</sup>

Thus in market economies entrepreneurship is a key to economic development. It is through self-employed entrepreneurs that development can be enabled.

This is evidenced in a report from the Brussels-based think-tank, the Lisbon Council.

## The micro-multinational is taking over

The Lisbon Council<sup>10</sup> has observed one of the outcomes of the move from a managed to an entrepreneurial economy. Its October 2011 report *The Rise of the Micro-Multinational: How Freelancers and Technology-Savvy Start-Ups Are Driving Growth, Jobs and Innovation* argues that the micro-multinational is taking over.<sup>11</sup> Technology and social trends are enabling individuals to compete with big companies, even globally. This is where all the jobs and innovation growth is occurring, the report suggests.

Quoting directly from the report, it says:

- A new type of company is emerging, one without bureaucracy.

At the forefront of this seismic shift in the way jobs are created and economic value added is a new type of company, the micro-multinational. Traditionally, these small, self-starting, service-driven companies would have been described as small- and medium-sized enterprises, or SMEs, but thanks to the Internet, the emergence of new business platforms and the increased openness of the global economy, these companies can enter markets with a minimum of bureaucracy and overhead.

The difference over time is a revolution in the way economic value is created, with smaller companies now able through technology to gain the scale that only larger ones could previously aspire to.

- Entrepreneurship is the only game in town!

Over the long-term, however, prevailing labor market trends suggest that fostering entrepreneurialism is really the only job creation game in town.

- Micro-multinationals are drivers of large enterprises!

Far from being the weak link in the New Work Order described above, micro-multinationals will not only be important innovators in their own right (especially given that their innovations are typically disruptive); they will also play an essential role in the innovation ecosystems of large enterprises.

In today's economy, small is an asset, and being large often a liability ... Micro-multinationals pose a formidable intellectual and policy challenge for domestic innovation systems. Not only do they undermine the validity of domestic showcase innovation initiatives, such as clusters, but they also hold the potential to be politically sensitive.

- A government policy framework:

The ensuing rise of micro-multinationals has already seen positive spillover effects on the larger economy but their potential is far from exhausted. Indeed, faced with horrid unemployment rates and low growth, changing policy levers to empower these dynamic players would go a long way to driving growth, jobs and innovation.

- The report identifies what governments should do, including:

Develop and encourage the range and quality of services on offer to local businesses and individuals.

Create the right incentive structures for freelancers and the self-employed. (eg) Unemployment benefits and health insurance coverage should neither be tied to an employer nor should they be denied to freelancers or the self-employed (US and EU).

- Finally

We're dealing with an outdated employment system – it was built for a workforce from the 1930s, and it no longer works for us today,” says Sara Horowitz, founder of the Freelancers Union, a non-profit organization that represents America's independent workforce. Ms. Horowitz is right.

It is to this—a new reality and framework about the world of work—that the GEEIndex brings its assessment tools.

## Other indexes

The GEEIndex can be located within the context of several other innovation and entrepreneurship-measuring indexes across the globe. Each of these indexes provides valuable and unique insights. The GEEIndex adds to that value and complements the other indexes because it is highly exact in identifying specific government regulations.

### ***Global Entrepreneurship Monitor (GEM)***<sup>12</sup>

The Global Entrepreneurship Monitor (GEM) is the oldest and best known of the indexes, with perhaps the largest of databases in this area of research. The value of GEM to the GEEIndex is that both focus on the individual as an entrepreneur. One principal difference is that GEM also includes employees as entrepreneurial players. The GEEIndex, on the other hand, is focused solely on self-employed people. GEM provides

some excellent behavioural and attitudinal profiling of entrepreneurs. The GEEIndex, by contrast, specifically considers the impact of government regulations on the ability and effectiveness of being a self-employed entrepreneur.

Some background on GEM:

- Started in 1999.
- Now has 54 participating countries.
- Says that there are 400 million individual entrepreneurs in the 54 countries studied<sup>13</sup>
- Provides an annual assessment of the entrepreneurial activity, aspirations and attitudes of individuals across a wide range of countries.

The program has three main objectives:

- To measure differences in the level of entrepreneurial activity between countries.
- To uncover factors leading to appropriate levels of entrepreneurship.
- To suggest policies that may enhance the national level of entrepreneurial activity.

GEM says:

GEM is unique because, unlike other entrepreneurship data sets that measure newer and smaller firms, GEM studies, at the grassroots level, the behaviour of individuals with respect to starting and managing a business.

Policy recommendations that improve the flexibility of labor, communications and market openness while eliminating bureaucracy and red-tape will contribute to a more entrepreneurially-focused business environment.

To create energy for making positive changes, societies must consider that entrepreneurship is not the heroic act of a few individuals, but the accomplishments of many people who pursue their ambitions in a supportive cultural and institutional environment.<sup>14</sup>

### ***The Global Innovation Index<sup>15</sup>***

The Global Innovation Index focuses on the connection between research at the university/academic level and its translation into product/knowledge by firms with support from government. It largely considers innovation as it happens between big government, big universities and big business. It says “The level and standard of education and research activity in a country are the prime determinants of the innovation capacity of a nation.”

The 2011 report is available online.<sup>16</sup>

Focused at the higher end of the spectrum of economic activity, the Global Innovation Index covers an area of innovation not covered by the GEEIndex.

### ***Global Entrepreneurship and Development Index<sup>17</sup>***

The Global Entrepreneurship and Development Index also has an interest in innovation from larger businesses. *The Economist* says that it

... focuses on high-growth companies. It tries to measure the ambition of entrepreneurs as well as the prevalence of start-ups. It presents its results in ways that are designed to capture the attention of policymakers. It produces a ranking of 71 countries (for all their faults, nothing makes a politician jump like a league table). It also identifies bottlenecks that prevent countries from doing better. The index concludes that development and enterprise are correlated.

## A Footnote

### *Cultural Influence on entrepreneurship*

The GEEIndex looks only at institutional and regulatory factors enabling or suppressing self-employed entrepreneurship. It does not consider cultural factors, but in the following discussion culture is recognised as highly influential because of the way it affects the preparedness of people to be entrepreneurial.

In a two-part article William (Denny) Dennis has suggested the employment of typology as a methodological tool for examining public policy in the field of entrepreneurship and small business.<sup>18</sup> In this he suggests that the two key factors in achieving economic change are institutions (formal rules) and culture (informal rules) each of which can be either favourable or unfavourable:

‘Favorable and unfavorable are positioned as independent entities, but in reality, they more closely resemble a sliding scale. Many public policies affect the overall entrepreneurial climate, whereas many cultural norms and traditions serve the same function. The result within each political jurisdiction or area within one is a unique mixture of institutional and cultural constraints that shape the incentive structure. If the incentive structures are different, it is reasonable to expect that economic outcomes over time will also be different.’<sup>19</sup>

The contrast between the influences of cultural and institutional support raises the question: when the two influences are opposed (with one being favourable and one unfavourable), which one is the stronger? To a certain degree it would appear that there is no single answer to this because the extent to which each influence can be favourable or unfavourable can also vary. Thus, one could be strongly favourable and the other only slightly unfavourable.

In this context the scope of the GEEIndex needs to be recognised. Because the Index does not measure, or seek to measure, cultural factors it is not a complete assessment tool of any given society’s entrepreneurial environment. Rather, by looking at the way government regulations affect the self-employed, the GEEIndex becomes a tool by which government may review how its behaviour affects self-employed entrepreneurship.

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## Part Three: SPECIFIC INDICATORS

This section discusses the specific indicators that make up the Index.

### **Measurement 1: The difference between employment and self-employment is an entrepreneurial indicator.**

The first set of measurements looks at the extent to which individuals are allowed to be self-employed as opposed to being forced to be employees. Even though it is rare for laws to prohibit self-employment (although some jurisdiction do outlaw it), government institutions, laws and practices frequently discriminate against self-employed people in a way that effectively prevents self-employment from being taken up. [Note; Until recently Cuba prohibited self-employment, small business activity. The US state of Massachusetts has specific laws that prevent the engagement of self-employment people.

The capacity and right of individuals to become self-employed should be something that is easily exercised. It should be something that does not face blockages because of government institutional biases. That is, government should not presume a moral, administrative or legal position against people being self-employed and favouring employment (or vice versa). Where governments do act with a bias against self-

employed people, it is effectively state-created institutional discrimination that harms entrepreneurship and limits the possible innovation that flows from that.

However, it is evident that in many, perhaps most, if not all jurisdictions, this bias and discrimination is entrenched in government laws, regulations and practices. This part of the Index measures the extent to which this occurs and gives negative ratings where it does. That is:

- Where government laws and regulations make it more difficult to be self-employed, a negative rating is allocated. Such a rating means that a government effectively operates to suppress entrepreneurship and the potential for innovation.
- Where government laws and regulations embrace both employment and self-employment equally, without bias, a neutral rating is applied. This means that the government gives entrepreneurship a reasonable chance of operating within its community. It does not guarantee entrepreneurship, but at least government does not block it.

In applying this measure, consideration is given not only to how the laws and regulations apply directly towards self-employed people, but also to how they apply to the people/businesses/entities that seek to engage self-employed people. If laws and regulations make it difficult, confusing or uncertain about whether to engage self-employed people, this too creates discrimination against self-employed people. This is because self-employed people need to have clients if they are to earn an income. If their clients or potential clients can't have clarity under law when engaging self-employed people and if this creates risk, then this diminishes the willingness of entities to engage self-employed people. Without clients, self-employed people do not have a business, cannot be entrepreneurial and innovation cannot follow. Government directly affects this.

The laws that can be studied in this respect are common in many economies and jurisdictions across the globe and have general features that enable standard measures to be applied. This is because, since WWII, large numbers of tax and welfare laws and regulations have been created that are constructed around the assumption that 'workers' are employees. The legal and administrative triggers created to enforce the laws frequently rely on the existence of 'employment' for their authority. Where individuals are self-employed this, by default, almost challenges the authority of the laws and institutions. This creates problems all round. In some jurisdictions these laws have been remodelled to remove the problem.

### ***Income tax withholding (collection) laws***

When income tax became popular with governments around and post the period of World War II the vast bulk of workers were employees (95% plus). In designing income tax laws it was (and is) administratively easier to require 'employers' to withhold income tax from employees and send the money to the tax authority. Hence 'withholding' laws impose legal obligations on employers to remit tax. The taxing authorities' power to require withholding is tied to the existence of employment.

From around the 1970s, as self-employment grew, the existence of larger numbers of people working outside of employment created problems for the taxing authorities. The authorities:

- Sometimes do not have clear legal authority to require withholding from self-employed people.
- Have more difficulty auditing and checking that withholding is occurring when it involves huge numbers of individual self-employed people than they do with a much smaller number of employers.

- Have difficulty chasing deliberate tax-avoiders when they are individuals simply because they don't have the resources to track and catch large numbers of individuals. In addition, the money spent chasing avoiders is often more than the revenue to be gained.

For these reasons, tax authorities have a history of seeing the rise of self-employment as a threat to the 'integrity of the tax system', threatening even the viability of government revenue-collection itself. Sometimes these claims border on the hysterical.

The response of tax authorities to this 'threat' has followed several patterns:

- They have aggressively sought to redefine self-employed people as 'employees', thereby requiring the 'client' to be declared an 'employer'. The attack is not against self-employed people directly, but rather indirectly, by forcing them into a 'declared' employment relationship which, as a result, denies the self-employed person business tax status. Because the tax authorities have the financial and legal power of government behind them, they can afford to run expensive legal cases whereas the business people under attack have difficulty funding defences. The tax authorities 'win' by intimidation. This situation is common across the globe
- In some jurisdictions, tax laws have been changed so that self-employed people are allocated withholding obligations. This happens when tax authorities realise that the number of self-employed has become so large that they cannot 'defeat' the trend by attacking self-employed people. That is, they are better off accommodating themselves to the situation.
- A combination of both aggression towards, and accommodation of, self-employed people

This index applies measures to see if the income tax system and its operation are dependent on the existence of an employer-employee relationship and hence discriminate against people being self-employed.

The sub-tests for this are:

- Is the revenue collecting authority dependent on the legal existence of employment for its authority to collect income tax?
  - If 'yes', do the authorities assert the right to assess whether employment exists without reference to the courts?
  - If 'yes', do the authorities refer the matter to an independent, low-cost, dispute-settling body?
  - If 'yes', do the institutions cover the cost of legal defence of the alleged employers they are attacking if the matter is taken to court?
- Have the revenue-collecting authorities had additional powers conferred on them to require withholding from self-employed persons?
  - If 'yes', is there evidence that the tax authorities administer this in an effective way in accordance with their legitimate powers or do they continue to discriminate?

### ***Business tax rates and deductions applied to self-employed people***

If an individual is in business even as a business of one, if the tax authorities do not give that person access to business-style tax treatment, then effectively that person is being denied the right to be a business. The question to be answered is straightforward. Does the person, using whatever legal business structure they choose (eg, partnership, company, trust, individual) have full access to the business tax deductions that any business would

have in earning income? That is, are legitimate expenses incurred in earning gross income allowed to be fully deducted to arrive at net, taxable income?

The history of taxing authorities is that they are highly suspicious of people who are businesses of one, or even two. It seems that they cannot conceive of a person being anything other than an employee when they work. When an individual is a business, tax authorities tend to 'see' a tax dodge of some sort. They consequently have a history of denying individual small business people their legitimate access to tax deduction expenses.

From the other perspective, however, many individuals try to claim business expenses that are not really expenses related to earning an income. That is, they claim personal expenses as business expenses—for example, holidays. It is legitimate for taxing authorities to clamp down on this because it is illegal and fraudulent.

Consideration of this issue must be done within the context of a balance between the rights of self-employed people to access business-style tax treatment and the obligations imposed on taxing authorities to administer tax laws. In assessing this balance, four considerations are required:

- Do the tax laws specifically deny self-employed people access to business-style tax treatment? If they do, the laws are intentionally discriminatory and suppress the development of individual entrepreneurship.
- Are the tax laws expressed with clarity so that self-employed people can clearly know what the rules are? Or are the rules unclear or ambiguous? If the rules are unclear and open to extensive and costly legal interpretation, then the effect of the laws is to discriminate against self-employed people.
- Are the tax laws simple and clear in giving self-employed people access to business tax treatment? If they are, the laws are not discriminatory.
- If the tax laws are clear, does the tax authority apply the rules with transparency and impartiality, or do the authorities breach their own rules, in the process intimidating self-employed people out of being self-employed? If the tax authorities do not apply the rules with transparency and honesty, the behaviour of the authorities is discriminatory.

### ***Payroll and other tax laws***

Income tax laws are the tax issues that most affect self-employed people across the globe because most nations/jurisdictions rely heavily on income tax for government revenue.

However, many governments also rely on other forms of taxation and some of these are similar to income tax in that they depend on the employer–employee relationship as the collection trigger. One of these is payroll tax.

Under payroll tax, employers are obligated to pay additional tax for each employee they employ. They do not pay the tax on business-to-business transactions. But now that many individual people are self-employed and operating as businesses the taxing authorities again have a conceptual problem. If an individual contractor is doing work for a firm, the contractor 'looks like' any other 'worker'. That is, the person is an individual doing work. As with income tax, the payroll taxing authorities perceive significant tax revenue losses if firms start engaging lots of self-employed people. The response has been similar to that invoked by income tax authorities (see above).

The questions to be considered are also similar to the aforementioned income tax issues and mainly relate to clarity of the law. That is, under payroll tax laws, the tax to be paid has frequently been extended to include a tax on remuneration paid to self-employed

people as well. Governments and taxing authorities have a legitimate right to do this if they wish. (A debate over what is a good or bad tax is not a consideration in this Index.) What is relevant is clarity under law.

The questions are:

- If payroll (or similar other taxes) have been extended to include tax on remuneration paid to self-employed people, are the laws in this respect clear as to who is 'in' and who is 'out'? If the laws are unclear, then a business engaging a self-employed person is in a quandary. Does it pay the tax or not? If it doesn't pay the tax, is it incurring an unknown liability that may be imposed on it at a future date? Such uncertainty is bad for business, constituting 'sovereign risk' because of badly formulated law. This effectively becomes an act of discrimination against self-employed people because it creates unknown risk for the engaging party when contemplating doing business with self-employed people.
- If the law is clear, (again) do the taxing authorities apply the law with transparency, or do they impose a form of intimidation by seeking to apply 'unwritten' rules?

### ***Superannuation/Pension retirement laws***

Many jurisdictions operate compulsory superannuation/pension schemes. Commonly, individuals have an account with a superannuation/pension fund into which contributions are made. Upon retirement, individuals draw on the fund.

Contributions to the funds are made under a number of likely models which vary between jurisdictions.

In most jurisdictions, the employer makes contributions on behalf of employees as a deferment of wages or in addition to wages. Sometimes, employees are required to make additional contributions.

The schemes can become complex in relation to self-employed people. This can vary between jurisdictions. Some schemes:

- exclude self-employed people from compulsory contributions.
- extend contribution requirements to the payer of the worker, including some or all self-employed people within the definition of worker.
- require self-employed people to make compulsory contributions.

The issue relating to the ability to be self-employed is one of clarity under the law. This Index does not seek to debate the merits or otherwise of compulsory superannuation/pension schemes. Rather, it asks does the design and operation of the scheme/s create commercial risk? That is, is the law clear in terms of whether a payer or self-employed person is required to make contributions?

If the law is clear, parties know their commercial obligations and can arrange their finances and contracts accordingly.

If the law is unclear or ambiguous, parties are in an environment of risk. If they make contributions when not required, they have incurred potentially unnecessary expense. If they don't make contributions and authorities subsequently decide that contributions should have been made, the parties find themselves with retrospective financial obligations which have not been budgeted for. Lack of clarity in the law creates high commercial risk. This diminishes the willingness of businesses to engage self-employed people and/or the enthusiasm of individuals to be self-employed and entrepreneurial.

## ***Workers' compensation laws***

Most developed economies have workers' compensation schemes. These are designed so that if a worker is injured at work, his or her medical expenses are covered, along with payment made to them for lost earnings. Where they exist, the schemes vary significantly across jurisdictions. This Index does not consider the value or otherwise of such schemes but rather (like compulsory superannuation) how the schemes define who is 'in' or 'out'. Again the primary issue is one of clarity.

Some schemes are 'universal'—that is, funded out of consolidated revenue or additional tax charges on personal income, for example.

Other schemes are standalone funds (like superannuation) and obtain their revenue from compulsory contributions from employers. Injured workers are covered by set schedules. Schemes are specifically designed to cover only employees, but will often 'extend' to cover some self-employed people. Again, when this occurs, who is 'in' and who is 'out' can be highly confusing. This becomes particularly difficult when, for example, a self-employed person who was not in the scheme, becomes injured and then seeks to claim that he or she was an employee. The possibility of retrospective claims create high potential risk for businesses that may want to engage self-employed people. This diminishes the willingness of people to make use of self-employed people.

As with compulsory superannuation, the question is one of clarity and certainty under law to remove the risk created by badly designed laws.

## ***Medical Insurance laws***

Medical insurance faces the same problems as workers' compensation schemes and again will vary across jurisdictions.

In some jurisdictions the cost of general medical expenses is covered from consolidated revenue, with residents in the jurisdictions having the option of taking out additional medical insurance coverage and/or paying for additional expenses from their own pocket.

In other jurisdictions medical expenses have little or limited coverage through general tax revenue and are entirely covered from private insurance or one's personal pocket. The schemes vary significantly across jurisdictions. Some private insurance schemes are like superannuation where individuals make contributions into an insurance fund where they build a personal 'account' from which medical expenses are paid. Others operate more like a general insurance fund.

Some jurisdictions have compulsory medical insurance schemes which can be similar to compulsory superannuation and/or workers' compensation. Contributions must be made by employees and/or employers, with self-employed people not covered or coverage 'extended' to them. Again, this Index does not seek to comment on the merits or otherwise of each of the possible schemes. Rather, if a jurisdiction has a compulsory scheme, the issue is one of clarity. If the scheme, by its design, is unclear, then it creates risk both for the self-employed person and for the businesses that may seek to engage them.

## ***Social security and unemployment benefits***

Access to unemployment benefits and other social security benefits falls under similar categories as superannuation, medical insurance and workers' compensation. The systems across the globe vary.

In some jurisdictions, unemployment benefits are paid from general tax revenue and are

usually available on a universal basis. That is, it is the fact of not having work that determines the payment of a benefit and not whether an individual has exited ‘employment’.

Other jurisdictions operate with self-funded insurance type schemes. Employers have obligations to pay into the schemes on behalf of employees. If an employee loses his or her job, he or she can apply for unemployment benefits from the scheme. For self-employed people the situation can vary between jurisdictions. Some jurisdictions require self-employed people to pay into the scheme whereas for others it can be voluntary. Receipt of unemployment benefits is usually only granted to those people who have made contributions to the scheme. As with other social welfare schemes (see above) the key is clarity. That is, when are contributions required and when are they not required?

If the law is not clear, disputes arise if an authority claims that contributions should have been made either by the self-employed person or his client/s. Again, it’s a risk assessment issue. Most disputes in this area are similar to disputes over income tax withholding in the way in which they play out. Again, lack of clarity creates risk for self-employed people and those who might engage them. Generating such risk effectively creates a form of discrimination against self-employed people and their ability to be entrepreneurial.

### ***Occupational Health and Safety (work safety) laws***

Modern work safety laws developed out of principles formulated in the United Kingdom in the 1970s. Most current OHS legislation in developed economies was designed in the 1980s. At that time the assumption was that most people worked in an employment relationship. Consequently, most OHS laws, and even the international conventions on OHS, tend to be written in such a way that the ‘employer’ has obligations to keep the ‘employee’ safe. Over the last decade or so, there has been a growing recognition that self-employed people are both employer and employee (of themselves) and that they can ‘fall through’ the cracks in the law. In some jurisdictions, OHS laws have been updated to incorporate self-employed people in both the responsibility and protection loops.

In making an assessment for this Index, OHS laws are an important indicator about whether jurisdictions understand, conceive of and place importance on the role of self-employed people in national workforce mixes. OHS laws hold people responsible over matters for which they had/have control.

The questions to be considered are:

- Do jurisdictions’ OHS laws hold self-employed people responsible for safety only over matters for which they have control?
- Do the laws recognise self-employed people as self-controlling individuals within the workplace?

From the perspective of this Index, the question is whether self-employed people are formally accommodated within the OHS laws. Self-employed people are a significant subset of any nation’s workforce and to have them excluded from the operation of OHS laws demonstrates a significant—and even dangerous—gap in the thinking of government. To exclude self-employed people from OHS laws creates confusion over the parameters within which individuals can conduct their business.

### ***Anti-discrimination and Equal Opportunity laws***

Anti-discrimination laws have an odd feature when applied to the employer–employee relationship because of the existence of the legal concept of ‘vicarious liability.’ Within the employer–employee relationship, if an employee discriminates against another individual, the employer is held responsible and liable for the employee’s actions.

Self-employed people, however, are held liable for their own actions, just as any individual is in private life. The questions raised by anti-discrimination and equal opportunity legislation are similar to those under OHS laws.

- Are self-employed people considered within the anti-discrimination laws of jurisdictions?
- Do the laws recognise the significant difference between an employer-employee relationship and self-employment?

If these recognitions do not exist, they demonstrate a discriminatory aspect of the design of anti-discrimination laws.

### ***Labour (industrial relations) laws***

Industrial relations laws specifically govern the relationship between employers and employees. Such laws operate on the premise that the employment contract is one in which the employee is subservient to the employer. Broadly speaking, the laws seek to impose controls or limitations over employers' capacity to exercise unfettered control. Thus, jurisdictions impose minimum or prescribed wage rates that employers must pay, stipulate hours of work, holidays and even control over when and how dismissal of an employee can occur. Specialised labour courts operate to regulate the management of employer-employee disputes.

From the perspective of self-employed persons working on their own, these laws are not relevant to them. The essence of being self-employed is that an individual earns his or her income by working under the commercial contract. That is, they work in commercial market settings where price controls and other interference in business operations are not allowed. Their working lives are governed by commercial law not employment law. However, this area of law is highly political and inflames passion. There are frequent accusations made that self-employed individuals are really disguised employees. Further, it is sometimes argued that self-employed individuals are somehow victims of employer 'plots' to conduct exploitation, or that somehow self-employed individuals seek to damage the working conditions of employees. It amounts to a demonisation of self-employed people.

In relation to self-employed individuals working on their own, it is not relevant for this Index to assess the validity or otherwise of such arguments. Rather, it is necessary that industrial relations (labour) laws respect the right of people to be self-employed and not subject to industrial relations laws. If labour laws declare otherwise, or if by some fashion, they pull self-employed people into labour regulations, the jurisdiction effectively prevents people from being self-employed and entrepreneurial.

In this respect there is only one question to be considered:

- Are labour (industrial relations) laws clearly restricted to the employer-employee relationship or do they seek to 'pull in' self-employed people as well?

The other issue for self-employed people is when they expand their business beyond themselves as individuals and engage other people to help them. They can do this by networking with other self-employed people, using commercial arrangements. Alternatively, they can become employers. Statistics indicate that around half of all self-employed people are also employers, mostly of only 1 to 4 employees. For these self-employed people, the industrial relations laws are highly relevant.

When a self-employed person becomes an employer, the income of the self-employed person is still sourced and governed through and by commercial law. However, the relationships they have with their employees is directly controlled by industrial relations

laws. Their ability to act as an entrepreneur is consequently, heavily affected by industrial relations laws and practices. For this Index's purposes, there are a wide range of questions to be considered, depending on the specific application of industrial relations laws in each jurisdiction.

[Note: The Index will only consider the impact of industrial relations laws on entrepreneurship from the micro-business perspective—that is, very small businesses where the owner is self-employed, directly runs the business, is personally at risk and only employs a small number of other people.]

But there is one conceptual overarching consideration—namely, to what extent do the industrial relations employment laws limit the ability of self-employed people to manage their business and are they exposed to additional risk as a result of the laws? We need to remember that for the self-employed person who takes on the legal status of 'employer', any risk exposure is personal risk. If things go wrong, the self-employed person bears the consequences and financial losses personally. This is quite different from large businesses or government organizations, where loss is dissipated through the organisation to the extent that, typically, no individual working in it suffers any personal loss.

Issues to be considered include:

- If unfair dismissal laws exist, do the laws make available quick and cheap dispute-resolution processes? If the dispute process is legalistic, requiring the expense of lawyers, the self-employed person suffers losses immediately (in the form of lawyers' fees). Unfair dismissal laws can create high levels of risk for self-employed people.
- Assessment needs to be made of the broader employment regulations to see if they restrict the ability of self-employed people to manage their business. If this occurs, the risk factors for self-employed people rise significantly.

### ***Laws that specifically prohibit self-employment***

In some jurisdictions, self-employment is specifically outlawed. This was the case, for example, in Cuba until quite recently. Now Cuba is quickly opening its economy and allowing people to be in business. However, even in some 'developed' economies self-employed is outlawed. Massachusetts USA has a law that effectively prevents businesses from hiring independent contractors (self-employed people). Such laws must receive a significant negative rating under this Index.

## **Measurement 2: The commercial contract and its connection to entrepreneurship**

The second major area that requires investigation is the extent to which laws and practices around commercial contract transactions enable self-employed individuals to have measures of equal rights under contract, as against large businesses and government.

The intent and structure of commercial contracts (under common law) is that all parties to a contract have equal rights to control the contract. Conceptually, parties to a contract enter the contract under offer and acceptance, under terms to which they have agreed and, if there is a dispute, they can ultimately go to the courts for resolution.

This works well when the parties to a contract can afford legal advice in somewhat equal measure. However, there is a practical problem for self-employed people when they enter contracts with large organizations, either big businesses or particularly government. What tends to occur is that the large organization creates standard 'form contracts' that are legally designed exclusively to protect the interests of the large organization. When a self-

employed person does business with such an organization, they are 'required' to conduct the business under the contract stipulated to them by the large organization. The outcome is that the self-employed person's capacity to operate under a contract that looks after his or her interests in equal measure to the large organization is neutered.

There are some who argue that this is fair enough, that it's the nature of business and that self-employed people don't have to accept the work. That's all true. But, in effect, the ability of the self-employed person to truly be in control of his or her own business becomes highly constrained under such contracts. The risks in being in business rise dramatically. This in turn not only limits the ability of self-employed people to be self-employed (that is, they may be better off being an employee), but it also limits the capacity of the self-employed person to be entrepreneurial.

As this Index seeks to measure the ability of self-employed people to be entrepreneurial, working under fair and balanced contracts is important. The task is not to limit the reasoned risk that a self-employed person decides to take, but rather to ensure that the risks they take are ones that they truly have chosen to bear.

In fact, under common law, the 'structure' of commercial contracts has to conform to a particular pattern for them to be considered a bona fide commercial contract. In general terms, the features that create a suspect commercial contract are ones where:

- Clauses give one party, but not the other, the ability to avoid or limit the performance of the contract.
- Clauses give one party, but not the other, the ability to change the terms or the price of the contract or renew or not renew the contract without reference to the other party.
- There are terms that enable one party, but not the other, to terminate the contract without compensation to the other party.
- Clauses that enable one party, but not the other, to determine whether the contract has been breached or to interpret its meaning.
- Once the contract is entered into, terms or conditions are revealed that were not declared or obvious before the contract was entered into.
- There are terms that permit one party to assign the contract to the other party's detriment without their consent.
- The language used is so confusing, unclear and/or heavily legalistic that it cannot be clearly understood by a self-employed person.
- Clauses that limit one party's right to sue the other party, or to limit the evidence one party can adduce in legal proceedings or impose evidential burdens on one party in legal proceedings.
- There is an allocation of liabilities to one party related to circumstances over which they could have no control. Usually this is related to the other party seeking removal of their own liability.
- There is a lack of clarity as to the identity of one of the parties.
- Alleged commercial contracts have many features of employment contracts such that their commercial contract status is suspect.
- Standard contracts are framed on a 'take it or leave it' basis such that the genuineness of intent is suspect.
- Restraint of trade can be imposed on one party, but not the other, without adequate compensation.

There are lawyers who would disagree with this summation. They argue that ‘offer and acceptance’ is the only legal requirement for a commercial contract to be valid. This Index does not accept that argument. Further, the features of bona fide commercial contracts are features necessary if free markets are to function effectively—especially in relation to the involvement of self-employed people. If the weight of a contract’s structure is heavily against the self-employed person’s interests, then their ability to be in business, to be entrepreneurial, is heavily restricted. This of itself is damaging to economic activity.

In this respect, self-employed people are in a very consumer-like position when they enter commercial contracts with large organizations. If the contracts they enter are ‘fair’ and balanced, their capacity to be entrepreneurial is considerably enhanced.

This Index looks at jurisdictions to see the extent to which they have laws which secure measures of fairness under commercial contract (as described above) for self-employed people.

The laws should not, however, seek to impose terms on the nature or price of goods and services being supplied between parties. Having freedom to choose in this respect is integral to the ability to be entrepreneurial. In fact, it’s necessary for free market economic activity to exist. Confidence that commercial contracts into which people enter have a measure of ‘integrity’ is critical to an effective functioning of the rule of (commercial) law and the ability of self-employed people to be effective business operators, to be entrepreneurial and to contribute to economic development.

The measure being used in this Index can be applied to all commercial contract arrangements for self-employed people, including commercial retail leases, franchising agreements, services agreements (for example, information technology, engineering design) and so on.

### ***Dispute Resolution***

For self-employed people, obtaining comparatively quick, easy and cheap resolution to commercial disputes is an enormously important factor in reducing risk and enabling entrepreneurship.

Under many circumstances in many jurisdictions, court processes for settling disputes are time-consuming, excessively legalistic and expensive, to the point that the cost of settling a dispute (in terms of time and money) greatly exceeds the monetary value of the situation in dispute. The consequence is that the rule of commercial law is really only available to those who can afford or warrant the cost of litigation. Effectively, self-employed people are substantially excluded from the practical application of the rule of commercial law. This directly increases the risk of being in business and reduces the capacity to be entrepreneurial. The consequence is that economic activity is reduced.

In jurisdictions where quick, cheap dispute-resolution processes are available, self-employed entrepreneurial activity can be undertaken with greater confidence.

The existence of practical, affordable commercial dispute-resolution avenues for self-employed people is an important indicator in the ratings for this Index.

### **Endnotes**

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