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**Self-Employment
as a Form of Business**

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Self-Employment as a Form of Business

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Abstract

When forming a new business, one of the most complicated decisions an entrepreneur stumbles upon is choosing the legal form of the business. This choice depends on a number of factors: the type of business, the number of founders, available resources etc. For that reason it is essential to study all forms of business, find out their advantages and disadvantages. Self employment is a form of employment associable with person's greater freedom of choice as well as increased risk chance. Even though self-employment is usually considered a part of employment policy, in a diverse sense it can be regarded to as a first step towards forming a business.

Ignoring an opinion of certain economists who claim that the future economy belongs only to large corporations and small businesses will become ineffective, the role of self-employment remains important. Along with the development of concerns and competitiveness in the global market, the role of self-employment increases in the context of sustained development.

Self-employment is common in all 27 European Union (EU) member countries and envelops a number of employment sectors.

Self-employment is characteristic to conventional industries, for example, agriculture, forestry and fishery, retail business and crafts as well as construction industry. Among 27 EU member states the largest proportion of self-employed persons is found in tertiary sector * – wholesale trade, retail business, real estate deals, education, health. The number of self-employed persons in this sector is three times bigger than in primary (agriculture, forestry, and fishery) and secondary sector (manufacturing).

Where in Latvia the number of self-employed persons is the biggest in tertiary sector only since 2009, before 2009 the majority of self-employed persons registered in the primary employment sector. (Irmeja A." *The trends of self-employment in Latvia compared to the other European Union member states*).

Research problem: Nowadays the topic of employment and unemployment has become rather urgent, for the reason that unemployment in the EU as well as in Latvia has become one of the most important political, social, and economical problems. For example in 2010 the level of unemployment in Latvia was 18.7 percent, but in Greece 12.6 percent (Eurostat data). After losing a job, the quickest way to become financially independent is to choose self-employment as a form for one's business of selling own goods and services.

The **aim of the research** is to find out the role of self-employment among other forms of business. **Tasks:** 1) research forms of entrepreneurship in Latvia and Greece; 2) to find out motivation to become self-employment; 3) evaluate trend of self-employed persons;

Keywords: forms of business, self-employment, entrepreneur, entrepreneurship.

*The sector of employment is divided according to qualification of NACE 1.1 edition.

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Results and discussion

1. Forms of entrepreneurship in Latvia and Greece

Entrepreneurship is an important component of national economic life. Its development is one of the most important national economic policy tasks. The society is interested in the civilized conduct of business, so entrepreneurship should be free while legally arranged. Entrepreneurship development requires a stable legislation governing taxation, investments, financial and credit policy. In today's economy, the state has a major impact on entrepreneurship processes. On the one hand, the state may not restrict the freedom of entrepreneurship, but on the other hand, the state is to identify those frames every company has to fit in not to threaten public interests.

Before starting a commercial activity entrepreneur has to decide what type of company will be most appropriate for him. This choice depends on several factors: the availability of resources, type of entrepreneurship, number of the founders, existing legislation and other factors the author examines in this paper.

In the early nineties in Latvia, when the transition to a market economy began, the Law "On Entrepreneurial Activity" defining key principles for entrepreneurship and entrepreneurship forms was adopted. In the years 1995 and 1996, introduction of European Union's (EU) legal norms into Latvia's legal system became a very important issue. The Commercial Law entered into force on January 1, 2002.

With the entry into force of the new Commercial Law, interpretation of some entrepreneurship terms has changed. In the regulatory enactments, there are no such concepts as entrepreneurship, yet there is the concept of commercial activity. The Commercial Law defines the concept as follows: "Commercial activity is an open economic activity, which is performed by merchants in their name for the purpose of gaining a profit" (Commercial Law). According to the author, the entrepreneurship is based on personal interests realizing which all the needs of society are satisfied unconsciously.

Along with other laws the Commercial Law is one of the main state regulation instruments in the sphere of microeconomics which marked a significant change in the entrepreneurial environment. The Commercial Law provides forms of entrepreneurship or merchant types, shown in the Figure 1.

Each entrepreneurial activity form has its advantages and disadvantages, as well as characteristics, Table1. They differ in: company's owner degree of personal liability (risk); complexity and costs of company's registration procedure; capital attraction options; foundation procedures and types of investments; profit-sharing arrangements; the company's management and control forms; requirements for accounting records and tax payment.

Individual merchant (IK) (company) is the oldest, easiest and one of the most common commercial activity structures. He is the organizer of his own company, manager and owner in one person, so he is perfectly entitled to all

commercial activity's income, as well as has the opportunity to make decisions alone.

Individual Merchant has unlimited liability, it means he is liable for the obligations with all his property, including his personal property. Companies registered as Individual Merchant usually are small, belongs to the small business category, operating in trade and marketing sphere what does not require large capital investments.

A person who wishes to become an individual merchant, founding activities are alike as, for example, for capital companies. The only documents to be submitted to Enterprise Register for Individual merchant to be registered in the Commercial Register is the application and receipt of the payment of the registration fee in the amount of 28 EUR and receipt of the payment for publication in the amount of 23 EUR. Person's signature on the application and the person's capacity to act shall be notarised.

A natural person has a duty to apply himself or herself for recording in the Commercial Register as an individual merchant, if the annual turnover from economic activities performed by him or her exceeds 284 575 EUR, to perform activity special place to provide services or sell goods is set and more than five employees are employed. Analysing statistical data on registered merchants during the period from 01.01.2002 to 17.05.2012, the author concludes that Individual merchant takes the second place in the list the most popular entrepreneurial activity forms in Latvia (Commercial Register...).

Capital Company - the most common form of commercial companies in Latvia. "A capital company is a commercial company, the equity capital of which consists of the total sum of the value of the equity capital shares or stock" (Commercial Law). The key element of a capital company is equity capital without which the capital company cannot be founded. Forms of capital companies: limited liability company (SIA) - a private company, the shares of which are not publicly tradable objects, and stock company (AS) - a public company, the shares (stock) of which may be publicly tradable objects

Limited Liability Company has reduced foundation rules compared with stock company. In establishing a SIA, its equity capital could be paid by money or material contribution, but in establishing stock company - only by money contribution. The State fee to register SIA is smaller –143 EUR the State fee for registration of stock company is 355 EUR. Founder of a capital company may be a natural or a legal person who has signed the memorandum of association of a company. Capital Company, contrary to partnership, may be established by one person. Members have limited liabilities which mean he is liable with the part of property invested in the company, but not with personal property.

Partnership is a commercial company, the purpose of which is the performance of commercial activities utilising a joint firm name, and in which two or more persons (members) have united, on the basis of a partnership agreement.

Establishment of a partnership is relatively simple - the founders only have to sign partnership agreement. Partnerships do not need equity capital,

administrative institutions (board of directors, council) and do not require the articles of association. To register a partnerships in the Commercial Register, following documents shall be submitted to the Enterprise Register: an application signed by all founders (persons' signatures on the application and the persons' capacity to act shall be notarised), receipt of the payment of the registration fee in the amount of 142 EUR and receipt of the payment for publication in the amount of 34 EUR, as well as notarised sample signature of the founder of partnership, who is a natural person.

Depending on whether all members of a partnership are unlimitedly liable for company's liabilities or a member's liability against partnership's creditors is limited, partnerships are divided into limited partnerships and general partnerships.

To register a limited partnership you have to fill in the application, to pay the State fee and the fee for publication in the newspaper *Latvijas Vēstnesis*.

The most significant distinction of general partnership – all members are equal in rights and are fully responsible for company's liabilities. It means members of general partnership are responsible for the obligations of their liability with all their property.

General partnership's registration process is similar to limited partnership's registration process.

Similar to other EU member states, the most popular form of commercial activity in Latvia is Limited Liability company, the number of it on May 17, 2012, reaches 124 989. On May 17, 2012, there are 13 529 individual merchants, 102 limited partnerships, 388 general partnerships and 912 stock companies registered in Latvia (Commercial Register).

In the Commercial Law of Latvia, there is no form of commercial activity as self-employment.

The term of self-employment is explained in the law „On the Regulated Professions and the Recognition of Professional Qualifications" and in the law „On State Social Insurance”.

The law "On the Regulated Professions and the Recognition of Professional Qualifications" defines a self-employed as a person who earns employment income independently, without entering into contractual employment relations with an employer, and does not occupies a position that gives the right to remuneration (Of Regulated Professions...).

The term of self-employed is also used in the law "On State Social Insurance". **Self-employed person** - a person who earns income (or revenue) as: a) a person that performs individual work (this economic activity form is not registered since 2008); c) a person whose permanent place of residence is in the Republic of Latvia and who receives a royalty (copyright or neighbouring rights remuneration), except for an heir to copyright and a successor in interest to other copyright; d) a sworn notary; e) a sworn advocate; f) a sworn auditor; g) a doctor in practice, a pharmacist in practice, a veterinary practitioner, an optometrist in practice; h) another natural person who has registered as an economic activity income tax payer, i) an owner (owners) of a farm (fishing undertaking) who, not being in employment legal

relations with an administrative authority of his or her farm (fishing undertaking), performs the management function of such a farm (fishing undertaking) if, in accordance with the procedures prescribed by law, a manager (director) has not been appointed (elected) in such a farm (fishing undertaking); j) a person whose permanent place of residence is in the Republic of Latvia and whose work is remunerated from foreign technical assistance resources and loans from international financial institutions granted to the Republic of Latvia; k) a sworn bailiff.

In foreign publications and the EU's statistical publications, a natural person performing economic activities is called the self-employed. In laws and regulations of the Republic of Latvia relating to a natural person who performs economic activities, the term "performers of economic activity" is used. However, the term "self-employed" is used in a narrower sense, only relating social insurance of performers of economic activity. In social life and media, a self-employed are a natural person that performs economic activity registered in State Revenue Service and is not registered as an individual merchant.

In 2010, the research on self-employed persons was performed in all EU member countries. The research "Self-employed workers: employment relations and working conditions" performed by the European Foundation for the Improvement of Living and Working conditions, the European Industrial Relations Observatory, and the European Working Conditions Observatory (The report on Self-employed workers...).

The conclusion of the research is that the difficulties in reconciling a single "self-employed person" definition arises from specific local conditions in each country and the legal framework, as well as significant changes occurred in labour relations in recent years.

By contrast, to set the definition of self-employment the government in Latvia has developed the draft law "Natural Persons' economic Activity Law"; after it coming into force, the term "self-employed" in Latvia will be used in a broader sense, meaning any natural person (including individual merchant) who performs regular and systematic economic activity for remuneration.

In Greece there are four main kinds of entrepreneurship:

Limited liability Company (EPE). Minimal equity capital to establish EPE is 18 000 EUR. The equity capital should be paid-up during the founding and at least half of it paid-up in cash. Usually minimal number of members is two. EPE is very popular form of commercial activity in Greece due to limited liability. The financial report has requirements set by the law.

Stock Company (AE). Minimal equity capital to establish AE is 60 000 EUR. This is a standard form of commercial activity for the big public companies, while individual merchants widely use it due to elasticity. Board of directors and the auditor are required for AE.

Partnership. Partnership could exist in the form of a general partnership (OE) or limited partnership (EE). Foreign investors prefer limited partnership (EE) with limited liability. Minimal number of members is two, the minimum equity capital is not set, and usually it is 1000 EUR. Partnerships have a lower level of normative legal order.

Branch Foreign parent company should meet the Greece's equity capital requirements, as well as the foreign parent company is responsible for the branch's legal and tax affairs. It has to be registered in Greece's institutions. The minimal number of directors is one; there is no formal requirement for statements. Required to appoint a local representative who is individually and solidarity responsible for payment of taxes (Form of business...).

2.The decision to become self-employed

Why individuals become self-employed has been a central question of entrepreneurship research since the very beginning of the field.

This interest is due to the relevance of entrepreneurial activities to nearly all economies around the globe, and it explains why entrepreneurial families have been an important topic of study for both entrepreneurship and family business scholars.

Two explanations from very different angles dominate the discussion on why an individual becomes self-employed: a personality driven explanation and a behavioral explanation. While the personality-driven explanation stresses that individuals with certain traits have a higher probability of becoming self-employed (Rauch and Frese 2007; Zhao and Seibert 2006; Barrick and Mount 1991), the behavioral explanation highlights the fact that individuals tend to learn from others who are role models for them (Mancuso 1974).

Researchers have found that early exposure to parental role models in the family business will affect the children's attitude towards becoming self-employed themselves (Dyer et al. 1994; Carr and Sequeira 2007) and that growing up in a family with self-employed family members may lead to a general probusiness attitude of the children (Dunn and Holtz-Eakin 2000). Finally, children in an entrepreneurial family can benefit from being mentored by their parents and by accessing the business networks of their parents (Kim et al. 2006;).

While the above-cited and other studies demonstrate that role models in entrepreneurial families are generally influential for the motivation of their off spring to become self-employed, this evidence has not always been unambiguous. For instance, some studies have found that parental role models do not stimulate individuals to become entrepreneurs (Brenner et al. 1991; Kim et al. 2006; Ghazali et al. 1995), and in many entrepreneurial families children do not take over the businesses of their parents (Kepner 1983; Rodriguez et al. 1999). Thus, there appears to be considerable variance in the effect of parental role models on individuals' decisions to enter self-employment.

Research to date has pointed to four main themes of influence on the level of self-employment activity.

The first theme focuses on exposure to entrepreneurial culture and attitudes to risk. In empirical work these are proxied by parental background, such as whether a parent was self-employed, or whether a parent was responsible for managing others (Taylor, 1996; Henley, 2004). Attitude to risk

is very difficult to quantify. Some researchers have attempted to address this through the use of qualitative information on ability to accept anxiety.

The second theme concerns access to financial capital, encompassing the effects of capital constraints. Small or sole trader businesses generally rely on personal financial wealth, inherited wealth and real estate holdings as a direct source, or collateral for start-up and working capital.

Housing wealth is a particularly common source of collateral. Recent macroeconomic studies have established a strong relationship between the state of the housing market and inflows into self-employment (Cowling and Mitchell, 1997). Henley (2004) finds a significant housing market influence in micro data. Housing collateral has a direct impact on the success of self-employment because it influences the default premium set by lending institutions. The size of that premium might therefore depend on the current state of the housing market. Inheritance and windfall gain has been found in a number of studies to exert a significant influence on self-employment activity (Lindh and Ohlsson, 1996; Burke et al., 2000, 2002; Taylor, 2001).

The third theme concerns human capital. Most studies observe some correlation between educational attainment and self-employment status. Accumulated human capital may be a fundamental determinant of success in self-employment, since it may determine non-windfall financial wealth (Cressy, 1996). However recent longitudinal analysis (using the same data source as the present paper) finds little or no evidence for education affecting self-employment survival rates, although some evidence that the length of previous labour market experience may be important (Taylor, 1999).

The fourth theme concerns whether movements in self-employment are driven largely by cyclical or secular factors. Clear predictions about the cyclicity of self-employment are problematic because, while an economic upturn may create increased demand for the goods and services provided by the self-employed, it may also increase the returns to employed alternatives. Furthermore the impact of short-run changes in economic activity on small business activity may be absorbed through changes in hours rather than numbers. However, recent evidence at the individual level suggests a high degree of structural, rather than cyclical, persistence in self-employment (Henley, 2004).

3. Trend of self-employed persons

Since the most popular forms of entrepreneurship in Latvia are Limited Liability Company and Individual Merchant, they were selected for further analysis. The Figure 2 shows that the most popular form of entrepreneurship for last 10 years (if we use distinction of forms provided by the Commercial Law) has been SIA, followed by IK. In Latvia, till the year 2007 number of registered entrepreneurs, registering as SIA, IK and self-employed increased every year. IK number continued to grow until 2008. In the year 2008, economic decrease in Latvia begun and number of SIA, IK and the self-employed began to shrink as well. In the years 2010 and 2011, the activity

among entrepreneurs was observed, because in the year 2010 the number of SIA is close to the level of the year 2007, when rapid growth of economy in Latvia was observed. In turn, in 2011 the number of SIA is the largest number in the last 10 years and reaches - 16 845. Number of IK merchants decreases in 2009, 2010 and 2011. Number of self-employed declined rapidly as well. But looking at the number of self-employed persons, it should be taken into account that possibly actual self-employed number has not decreased - it is the decrease of self-employed persons making social contributions for them from the national minimal rate.

Among EU 27 member states average proportion of self-employed out of working population is 17%, in Latvia - 11%, and in Greece- 46%, Figure 3.

Overall, Latvia has one of the lowest self-employment indexes in the EU. That proves that people are afraid to take risks and start their own entrepreneurship, and those who pick up the risk are not always successful. Change in the number of self-employed is highly influenced by external factors, such as the unemployment rate in the country, national and EU support for small and medium-sized enterprises, access to finances.

The largest number of self-employed persons is in sectors such as agriculture, forestry, wholesale and retail trade, repair of motor vehicles and motorcycles, and construction. Among EU 27 member states, self-employed persons mostly choose the following sectors: wholesale and retail trader repair of motor vehicles and motorcycles, then agriculture, forestry and fishing and construction is in third place. In Latvia and Greece the largest number of self-employed are in agriculture, forestry and fishing sector, the second according to the number of self-employed in both countries is wholesale and retail trade, repair of motor vehicles and motorcycles, but in third place in Greece are professional, scientific and technical activities, while in Latvia - construction sector.

On average in EU 27 member states in recent years, number of self-employed persons in agriculture, forestry and fishing is shrinking. In Greece, number of self-employed persons in this sector in 2011 fell by as much as 7% relative to 2010. By contrast, in Latvia number of self-employed persons in agriculture, forestry and fishing sector is rising - in 2011 it increased by 18% relative to 2010.

Conclusion

Self-employment and entrepreneurship are important economic phenomena.

Self-employment is a numerically important form of economic status in many industrialized economies. Governments are increasingly identifying the small business sector as a potential engine of economic growth. An important indicator of the success of self-employment is the ability of small businesses to create employment for others.

Self-employment could be a first step to the entrepreneurship, despite similar to other EU member states, the most popular form of commercial activity in Latvia is Limited liability company.

If a person wants to be his own master but has doubts about entrepreneurial abilities and the idea, then he can register as self-employed person and see whether the business idea develops, whether he likes to be an entrepreneur. However, if a person realizes this is not meant for him, then he can check out and not be self-employed, but if he succeeds and likes it, he can continue to be a self-employed or re-register to another form of entrepreneurship.

Latvia has one of the lowest self-employment indexes in the EU. Among EU 27 member states average proportion of self-employed out of working population is 17%, in Latvia - 11%, and in Greece- 46%.

Among EU 27 member states, self-employed persons mostly choose the following sectors: wholesale and retail trader repair of motor vehicles and motorcycles, but in Latvia and Greece the largest number of self-employed persons is in sectors such as agriculture, forestry.

Exist a lot of points of view about why people decide to become self-employed person. Researchers have found main themes of influence on the level of self-employment activity. The main themes are parental role, entrepreneurial culture, financial capital, housing wealth, human capital (education) and secular factors.

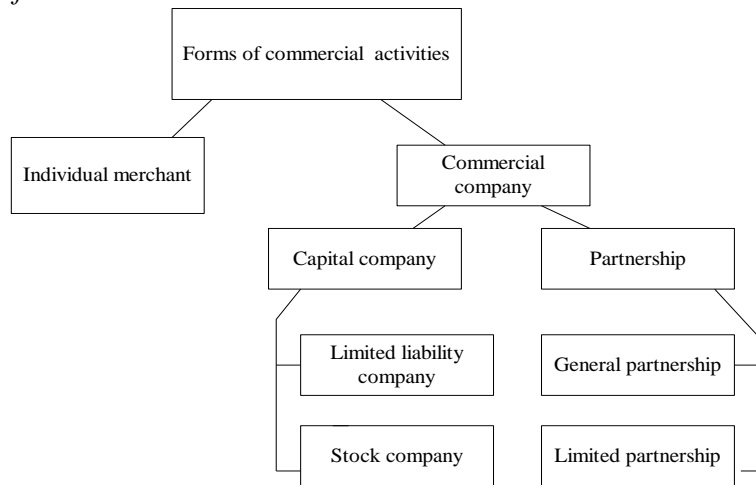
Recommendation for future research: Future research should investigate effectiveness of each forms of entrepreneurship. Find out which forms of entrepreneurship generate more jobs and how it is influence on economic growth.

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Figure1. *Forms of entrepreneurship according to the Commercial Law of the Republic of Latvia*



Source: authors' calculations based on Commercial Law

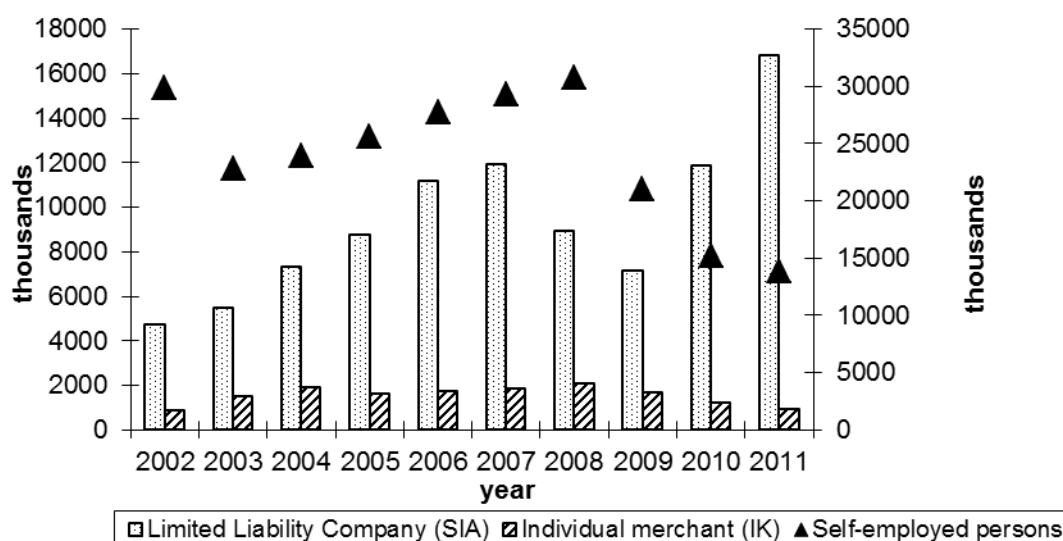
Table1. Advantages and disadvantages of self-employed person, Individual merchant and Limited Liability Company

| | Self-employed person | Individual merchant IK | Limited liability company (SIA) |
|-------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------|
| Advantages | 1) Self-employed person registers only in SRS; | 1) Simple incorporation and simple registration; | 1) Company income tax 15%; |
| | 2) No registration fee; | 2) May employ people; | 2) Limited liability (liability only with the SIA's property, except cases specified by the law) |
| | 3) No requirements on minimal equity capital; | | 3) Possible to found reduced capital SIA |
| | 4) Simplified accounting and accounting reports, it is possible to perform these functions without the knowledge of a professional accountant; | | |
| | 5) Possible to arrange accounting in simple entry system or double-entry system (preparing balance); | | |
| | 5) State mandatory social insurance contributions (VSAOI) payable only if the income exceeds LVL 200 (minimum wage) (or 200x3, payers of 3 fixed tax rate); | 5) Activity's requisites are separate from the personal requisites that allows a precise distinction between the activity's and private costs; | |
| 6) May employ up to 5 people (only self-employed - performers of economic activity) | 6) Road Traffic Safety Directorate (CSDD) registers vehicles owned by IK that allows to use their expenses for 100% | | |

| | | | |
|----------------------|---------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------|
| Disadvantages | 1) Full liability for results of activity (with all property); | 1) High registration expenses (100Ls+24 Ls+ notarization of signatures); | |
| | 2) The personal income tax rate in the amount of 25% is payable annually in advance when submitting annual personal income statement; | 2) Needed statutory capital at least 500Ls and property contribution - 500Ls or only money contribution in the amount of 1000Ls, except establishing reduced capital SIA | |
| | 3) VSAOI rate of 32.46% does not include unemployment insurance, because the self-employed person employs himself or herself; | 3) Restricted Possibilities to enlarge a company; | 3) Accounting requires specialized knowledge; |
| | 4) Restriction for the annual turnover is 200 000Ls, reaching that you shall register as IK | 4) Restricted financial resources because usually incomes of these merchants are small; | 4) Usage of personal property is disadvantageous |
| | | 5) Registration fee shall be paid, necessary to go to ER; | |

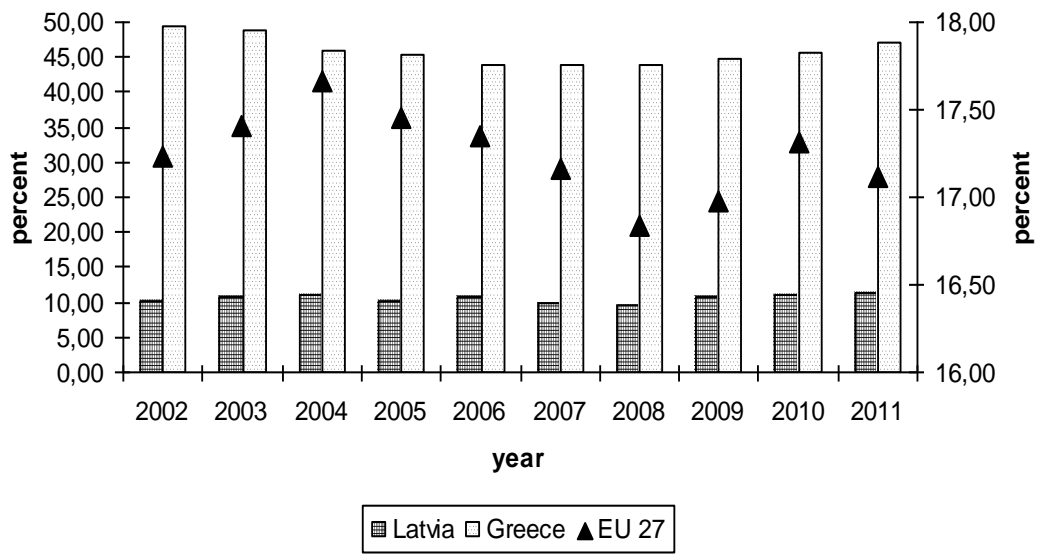
Source: authors' calculations

Figure 2. Number of Limited Liability Company, Individual Merchant and self-employed persons in Latvia from 2004 to 2011, in thousands



Source: Centra Statistical Bureau and State Revenue Service
 Self-employed persons who pay social contributions for themselves from the defined minimal rate.

Figure 3. *Proportion of self-employed of working population in the country 2002-2011, per cent*



Source: Eurostat