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4. The Cost of Informal Networking in the Western Balkans Region Matters!

This chapter explores the prominence of informal networking of individuals in the Western Balkans (WB) and their associated costs. We find that informal networking, or use of personal contacts for getting things done, is frequent and that the informal costs of networking amount to 100 Euros per month, which is substantial, given that the average income reported by respondents is around 250 Euros. In the structure of networking costs, the estimated costs of invested time, a proxy for sociability, dominate. We find that incurred costs are systematically higher for males, educated individuals and for entrepreneurs. As our key policy relevant finding, we establish that individuals in the WB region who invest into informal networking do so at a high cost, which implies that the culturally determined sociability of informal networking has an instrumental purpose. The evidence highlighting the power of economic factors points to the ambivalence – both sociability and instrumentality – of informal networking.

Keywords: informal networking, cost of time, cost of money, informal networking costs, Western Balkans, sociability, instrumentality, informal exchange, use of contacts

Introduction

One of our respondents, an entrepreneur, has explained to us the importance of socialising and networking in the Western Balkan countries as follows:

I was educated in the USA, and when I came back here I tried to do everything by the book, so I did not fully understand (informal networking) and did not accept this “Balkan mentality”, let’s call it in that way. This was the case until several years ago when I realized how our system is functioning, and that it was better for me to start socializing and networking more to find my ‘own people’. I could not progress without them. So, Yes. Some informal networks are built. But not in the state institutions. No. I have that possibility, but my priority is business.... Informal networking is primarily used to create new business opportunities, to target new clients together....’ (CRO_2)¹.

1 Acronyms used to code the interviews include: ALB for Albania, BiH for Bosnia and Herzegovina, KSV for Kosovo, MKD for FYR Macedonia and SRB for Serbia. The

The interplay between formal and informal institutions is associated with both formal and informal institutional costs, which inevitably translate to economic resources related monetary expenses, which should not be ignored. While we do have research on the costs of formal institutional environments (e.g. Wallis and North, 1987), its informal dimension is rather neglected in the existing literature. Why? A short answer to this question is simple: it is much more difficult to measure costs associated with informal institutions than those that are formal. A longer one involves complexity: although informal costs are linked to activities which are not formally visible, still every social interaction, including invisible ones, contains some costs (Marmaros and Sacerdote, 2006). Thus, in our study we analyse costs related to informal practices operating on the ground, as the first such research attempt, by asking the following questions:

How widespread is informal networking in the Western Balkan region?

What is the approximate cost of informal networking in the Western Balkan region?

To provide approximation for the costs of informal practices, we analyse the costs of informal networking in two sectors of the economy, the household sector (general public) and the business sector (entrepreneurs) in Western Balkans (WB) countries. Informal networking is a phenomenon which serves as a supporting intermediary mechanism for majority of informal practices in the formal economies of WB countries in focus. Informal transactions, exchange of information, experience and ideas as well as (self)enforcement are implemented through informal networks (supporting informal mechanism), which makes the phenomenon of informal networking sufficiently representative of informal practices in WB region. Therefore, our estimate of the direct and indirect (time) costs of informal networking is a good proxy for the costs of informal practices. Our intention is not to provide a precise calculation of these costs, but to suggest a way of approximation and useful numerical representation of these costs (time and money). Although the investigation provides regional analysis (Western Balkans), it has wider implications for the socio-economic literature on networks and informality.

number after the abbreviation is the ordinal number of interview (e.g. BiH_1, means interview number one in Bosnia and Herzegovina). All interviews are anonymised and archived following ethical guides from the INFORM project.

The underpinning analysis is based on quantitative and qualitative data; namely, a regional survey from the INFORM project is supplemented with qualitative interviews with entrepreneurs in the region. We find that individuals bear the high costs of informal networking not only for social and culturally determined reasons, but also with an instrumental purpose. Our evidence suggests that both sociability and instrumentality drive informal networking, in particular in the business sector. The network size and the associated costs are systematically higher for entrepreneurs, and it is business interest that motivates entrepreneurs to engage in informal networking, more than some traditional, cultural or other influences. On average, individuals and entrepreneurs spend around 100–160 Euros on informal networking per month respectively, with some differences between the countries in focus. There is a strong indication that the (opportunity) costs of (invested) time are larger than the real costs paid for informal networking.

This chapter is structured as follows. First, we provide a literature review covering informal networking and associated costs, which is followed by the section that explains the data and methodology. The main findings are presented in the penultimate section. The chapter ends with conclusions and relevant policy implications.

Informal Networking

The functioning of informality is impossible without supporting channels associated with informal networking. Informal transactions, favours, information, experience and ideas as well as their (self)enforcement are implemented through informal networks. Although informal networks seem to be a biographical by product, they are costly to establish, maintain and expand – it takes a lifetime of individual effort, time, and resources. The importance of informal networking varies across different sectors of the economy. The business sector is thought to be particularly associated with informal networking, thus informal institutions (Williams & Vorley, 2015). Informal institutions affect entrepreneurial activity and shape the behaviours of entrepreneurs (North, 1990; Valdez & Richardson, 2013; Williams & Vorley, 2015). Not only does the informal economy rely on

informal networking, but also, intriguingly, many formal businesses are in part informal (De Soto, 1989). The general business orientation of entrepreneurs is influenced by informal networks (Field et al., 2015), in particular in transition countries (Ledeneva, 1998; 2006), while more extensive business dynamics are identified among individuals who have entrepreneurs within their social networks (Klyver, Hindle, & Meyer 2008). While measuring costs of informality is a very demanding research task, measuring costs of informality in the formal sector is even more challenging (De Soto, 1989).

Informal institutions are used to complement or substitute formal institutions (Helmke & Levitsky, 2004; Furubotn & Richter, 2005; Brousseau & Glachant, 2008; Andersson, 2008; Efendic, Pugh & Adnett, 2011). However, the presence and costs of informality are caused primarily by the absence of good formal institutions, legal framework and good governance (De Soto, 1989). As the core channels of the informal institutions, informal networks serve a variety of purposes, from exchange of information, experience and ideas between agents to provision of goods, services, and favours that are not freely exchanged on the market (Jackson & Wolinsky, 1996). Establishing, maintaining and expanding of such networks incurs a considerable cost, but also brings significant benefits. The costs of informal networking depend upon network size, which is limited, given the finite nature of individual time and monetary resources. The available literature reports that density of networks has a significant influence on costs; higher density of informal networks lowers transaction costs (Henning, Henningsen & Henningsen, 2012). Moreover, the structure of networks might influence informal costs differently – network diversity based on race or ethnicity, for example, or networks based on family and friends, or acquaintances (Marmaros & Sacerdote, 2006; Silk, 2003) all might have different effects on costs.

Although any informal networking can be costly, the costs of maintaining informal networks in the business sector vary depending on the phase of business development (Greve and Salaff, 2003). At the initial stage of business development, entrepreneurs must identify their opportunities, find relevant resources, employees, and institutional support; informal networks and their diversity have a significant influence on addressing these challenges. Thus, informal networking is particularly important for entrepreneurs in the early stage of business development and in situations when formal institutions are underdeveloped (Chakraborty, Mukherjee, & Saha, 2015).

Great attention in the business literature on network structure has been devoted to whether strong or weak networks or ties bring more benefits (Granovetter, 1973; Greve & Salaff, 2003; Wang & Altinay, 2012). While strong ties (especially family-based) may provide the entrepreneur with emotional and motivational support, weak ties (acquaintances and more distant members) may better help to secure access to new knowledge and information (Efendic, Mickiewicz, & Rebmann, 2015). Accordingly, different combinations of strong and weak ties have a direct impact on discovering new opportunities and gaining legitimacy for entrepreneurs as well as on the informal costs of networking (Elfring & Hulsink, 2003).

The literature to some extent suggests that forming and maintaining informal networks leads to variety of costs, including in particular: cost of time and costs of money (Marmaros & Sacerdote, 2006; Brueckner, 2006; Silk, 2003; Pesämaa & Franklin Hair, 2007), which needs to be materialized and comparable. At the same time, informal networks seem to be beneficial for entrepreneurship growth when formal institutions are not sufficiently developed, which is the case with the countries that we investigate in our sample. Being inspired with the literature and evidence from the WB region, we provide the first study of informal networking costs, with the data coming from both household and business sectors of these societies.

Measuring Informal Networking – Survey Data and Interviews

To construct indicators on informal networking and their costs we rely on qualitative and quantitative data gathered in WB region. We use quantitative data collected through a targeted INFORM survey implemented in six WB countries (Albania, BiH, Kosovo, Macedonia, Montenegro, and Serbia) over the period March – June 2017. To collect this data, a multi-stage random (probability) sampling methodology was used to ensure representative samples. In every household, the ‘closest birthday’ rule was applied to select respondents, while every subsequent address was determined by the standard “random route” procedure. The dataset comprises 6,040 respondents from these countries, including 302 entrepreneurs, enabling

us an investigation that includes the general public as well as a subsample of entrepreneurs. The survey covers a variety of topics related to formal institutions and informal practices in the countries of WB. The relevant questions related to informal networking, including the size, structure and associated costs of networks, are included, which are used to construct variables relevant for our investigation.

We also conduct semi-structured interviews implemented in the WB region (namely, in Albania, Bosnia and Herzegovina, Kosovo, Macedonia, and Serbia) and two EU countries involved in the INFORM project (Croatia and Slovenia). The interviews were implemented among entrepreneurs who run or manage micro, small, and medium businesses. The interviews were conducted over the period November 2016 – February 2017. The majority of interviews were recorded with the approval of interviewees, coded to ensure the anonymity of respondents, organized in transcripts, and used for qualitative analysis. The effective sample includes 70 interviews: five in Albania, sixteen in BiH, five in Kosovo, ten in Macedonia, nine in Serbia and 25 in the EU (Croatia and Slovenia). Through these interviews, we also collected essential data about the interviewed entrepreneurs and their companies, including the costs of informal networking².

Informal Networking in the Western Balkans

The literature review provides indications that the size of informal networks might be linked with the total informal networking costs. Thus, our first step is to investigate the size of the informal networks reported by our respondents in the INFORM survey (Table 4.1). The obtained data suggests that the average network size in the WB region is 13 members, being the largest in Montenegro and Macedonia (19 and 16 members respectively) and lowest in Albania and Kosovo (8 and 9 respectively), while the other WB countries are closer to the average.

2 This chapter provides a summary of the key findings based on the both quantitative and qualitative data, and for the both sectors, household and business sector, while for a more detailed presentation of the data and empirical methodologies applied in this investigation can be found at Efendic and Ledeneva (2018) and at INFORM publications available at: <http://www.formal-informal.eu/home.html> .

Table 4.1. Estimated size of informal networking by different categories of individuals

Business status		Gender		Level of education			
Citizens	Entre-preneurs	Males	Females	Primary	Secondary	University	Postgraduate
13	17	15	12	10	14	16	13

Source: INFORM, 2017 survey data and calculations of the authors. The numbers are rounded.

If we look at the individual characteristics that might be associated with the informal networks size, we find that male respondents report slightly bigger networks and respondents with higher education, although this effect does not show a clear pattern. However, the highest effect in the sample has entrepreneurial status, where entrepreneurs report some 30% bigger networks. Our qualitative investigation of this pattern identifies that entrepreneurs are often explicit in saying that they are trying to expand their networks even further, because they see this as an important strategy for their further success, and some of them have built rather huge informal networks.

'If we look as far as to the lowest levels, then (my informal network) includes more than 100 people. Because, success can be measured by the size of your network. The larger it is, the more successful you are. It is better if you have someone you know at any (formal state) institution or it is you know someone who knows someone else. This is because everything is so complicated here. It is almost impossible to go to an institution and finish everything you need (without knowing someone there)... The more people you know the more progress you make in your business. And, I prefer to know more and more people on an informal basis (...) which means to know more people whom you are more or less ready to help tomorrow, and also, they are willing to do the same for you without going to lunch, without gifting and those kind of things' (BiH_4)

Most of the WB countries seem to have a similar performance when it comes to informal networking, the motives behind it and especially the ways in which informal networks are used. For example, in every observed WB country, entrepreneurs recognize the importance of having informal networks for establishing, developing and maintaining their businesses. It is business interest that motivates them to do the informal networking, more than some traditional, cultural or other influences.

'It is very hard to impose yourself today. In our society, there is still a system where you cannot make progress without some sort of informal connections. But, I wish we had a state without it...' (BiH_1)

‘There are segments in our society where, to put it simply, you just have to have informal connections even when you are meeting all other criteria; that is having the money, having a contract and other documentation – you just have to have the ear (in formal institutions) that listens to you in order to get what you need without damaging anybody.’ (BiH_10)

We identify that informal networks are used for different purposes, such as: to exchange ideas, information, knowledge, ensure access to the market, to compensate for the lack of rule of law, as a protective shell against political influence, but most frequently to avoid formal institutional rigidities and time-wasting procedures, unnecessary formal institutional costs, while in this diverse spectrum we identify even examples of informal networking providing personal psychological benefits. Still, a majority of entrepreneurs insist that informal networks are used primarily to substitute for the failures of formal institutional outcomes and to offset political influences in their business.

‘We utilize informal networks for getting information, speeding up procedures, getting new business deals. It is not just one thing.’ (MKD_3)

‘If we do not create informal networks in our business segment, we cannot function. You cannot rely only on professional relations. So, an informal network of contacts simply has to exist. If there was a regulated market in the country, these contacts would have been unnecessary. These contacts enable you to “swim in muddy waters.” If there was a more functioning rule of law in the country, one would not need these kinds of contacts.’ (MKD_3)

We recognize that where formal institutions relevant for business development are more efficient, informal networking is less present and used for different purposes. These two processes seem to be simultaneous – the more intensive informal networking goes hand in hand with the less credible formal institutions. Interestingly, we arrive to the same conclusion in our empirical investigation conducted with individual survey data (i.e. household sector). Conversely, the entrepreneurs and citizens operating in more efficient institutional environments use these informal networks to a lesser extent. In the first example, where informal networking is intensive, it is also used widely and for various purposes – from exchange of information and ideas to avoiding formal institutional complexities. When formal institutions are more efficient and credible, however, informal networking is less intensive, it is primarily used to complement formal institutions,

for exchange of ideas, and sometimes as a protective shell against political influence.

The entrepreneurs report 'aversion' towards informality and perceive it as a burdensome but necessary strategy to cope with the poor formal institutional environment. Although informal networking is frequently used in WB economies and is firmly integrated into the business cultures, it is not generally perceived as something positive, even if used, but rather as a necessary strategy 'to get things done'. ...*But, I wish we had a state without it...* (BiH_1). Once the formal institutional environment for business is improved, for which the best example is Macedonia as a non-EU, post-conflict and transition economy, informality is less used and the aversion towards it decreases.

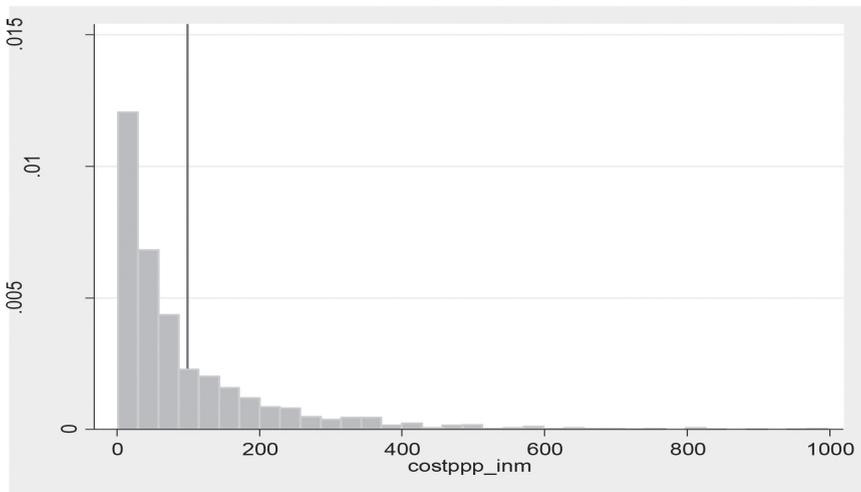
Entrepreneurs prefer to do their business relying on weak-tie network members, and sometimes strive to separate business from private relationships, if strong-tie network members cannot be avoided. This is consistent with the conventional business literature.

'To be honest I have heard this from various people but it is not my case. I keep separated my family, kin and friendship ties from my business. I prefer to do things by myself. The less one relies on such ties, the less troubles one has, this is my principle. So, I resolve my problems all by myself.' (ALB_4)

The main intention of our study is to provide an estimate of the cost of informal networking. We focus on two main types of informal networking cost – the costs of money (resources) and costs of time (lost opportunities). Our dataset contains information on both types of costs – estimates of time and money spent on informal networking by our respondents in WB region. To reach an estimate of money invested into informal networking over a typical week, we asked the respondents to assess their expenses on a nine category scale: 1) 0 Euro; 2) 1–10 Euro; 3) 11–20 Euro; ...; 9) over 100 Euro. We use the mean value of the scale to calculate the average amount of money invested by every individual. For the last category, which is open (over 100 Euro), we use 150 Euro as the mean value. The calculation of the time spent on informal networking is also based on a weekly scale: 1) 1-2 hours; 2) 3-5 hours; 3) 6-10 hours; 4) 11-20 hours; 5) over 20 hours. For the last category, which is open (over 20 hours), we use 30 hours as the mean value. Following the same procedure, we use the mean value of the scale to calculate the average time spent in networking over a typical week by every individual. In the next stage, we monetize the costs of time by calculating

the average value of a working hour (Euros) for every individual based on the information on their net monthly earning based on the following question: What is your monthly income, including all sources: income_1: up to 100 Euro; income_2: 101–200 Euro; income_3: 201–300 ... to the highest income category, income_9: over 1,500 Euro. The advantage of this approach is that it produces more accurate estimates, since we also have a question on their total income, from both formal and informal sources. After this transformation, we summarize the estimated costs of money and time expressed in Euros. In the final step, we use purchasing power parity (PPP) indices to equalize the monetary costs between different countries in the WB region and aggregate them to monthly totals. The estimated (aggregated) costs per month across the WB region (*costppp_inm*) are reported in Figure 4.1.

Figure 4.1. The total costs of informal networking in WB, in Euros, PPP adjusted



Our survey data suggests that, on average, individuals in the WB region spend around 10 hours of their time on informal networking and around 11 Euros per week for gifts, coffee, meals, parties and other related costs. The total informal networking cost, the costs of time and money standardized by the PPP index, is around 23 Euros per week, on average, and if aggregated at the monthly level, around 100 Euros (red line on Figure 4.1). In the structure of these costs, there is around 10 Euros reported to be spent in terms of money, while the remaining 13 Euros, on average per

week, is the opportunity costs of time (which is calculated based on the individual earnings of every respondents in the database). This means that the estimated (opportunity) costs of time are greater than the reported monetary costs. Comparing the total cost among countries, the highest monthly informal cost is reported for Kosovo (150 Euros, average net earnings reported in our dataset for Kosovo is 270 Euros), the lowest one in Serbia and Macedonia (80 and 85 Euro, average net earnings reported for these two countries are 240 and 250 Euros respectively), while the other countries fall closer to the average. The average net income in our dataset is 250 Euros.

Interestingly, once asked about costs of informal networking in our in-depth interviews, our interviewees recognize these costs well; they provide quantitative estimates, including both costs they spend in terms of money and the time they invest in establishing, sustaining and expanding informal networking. In addition, throughout our interviews we identify a substituting relation between money and time – more time is invested in informal networking in the early stage of business development, while more money is invested in the later stage of company's development, which is a consistent finding with business literature (e.g. Greve and Salaff, 2003). The entrepreneurs are rather explicit in trying to prevent any unnecessary time loss, even for informal networking, and apparently, they are buying their time with more money invested, which is the case when a business is more developed and financially stronger. The estimated costs of informal networking in our sample are larger for entrepreneurs by 60%.

Table 4.2. Estimated costs of informal networking by different categories, in Euros, PPP adjusted

Business status		Gender		Level of education			
Citizens	Entrepreneurs	Males	Females	Primary	Secondary	University	Postgraduate
95€	160€	120€	80€	50€	100€	150€	210€

Source: INFORM, 2017 survey data and calculations of the authors. The numbers are rounded.

The entrepreneurs are not the only category which reports much higher costs of informal networking. The level of costs is also gendered, where the male respondents report some 50% higher informal networking costs comparing to the female respondents. It also interesting to note that level of education provides a very clear pattern in the behaviour of these costs.

As the level of education of our respondents is getting higher, the average costs are also increasing. For example, the respondents with incomplete primary or primary education spend some 50 Euros on informal networking per month, while on the other end of the scale, the respondents with master or doctoral degrees spend over 200 Euros on informal networking per month. The effects of these individual characteristics might overlap (e.g. entrepreneurs might be more often male respondents who are more educated); hence, these influences might operate cumulatively, but at this stage we cannot say more on these effects.

Most entrepreneurs explicitly point to the blindness of informal networks to ethnicity and religion, which is a persistent problem for some of these formal institutional environments (e.g., BiH and Macedonia). This is a positive example, sending a message that informality (networks) deals better with ethnic and religious diversity than do formal institutions; the motives driving formal (political interest) and informal (in this case business interest) institutions are obviously different, and they produce different attitudes related to the role of ethnic heterogeneity in these societies.

'[...]my situation is that I don't really know the ethnic and religious belonging of people to whom I am connected, unless in cases when they say where are they from or to which religious group they belong. This happens because to me and my acquaintances this is not an issue at all.' (ALB_1)

'In my network, there are various people, people from different spheres of life. In business relationships the ethnic background is irrelevant, because everyone is striving towards the same goal that is the mutual satisfaction coming from the job done. Everyday activities establish business connections and ties, thus creating a circle of people where everyone knows what to expect from others.' (BiH_2)

'The people I work with come from different social and ethnic groups. Depending on one's needs (interest) business does not discriminate on the above stated criteria.' (MKD_2)

It seems that formal institutions in the region can learn and try to integrate positive messages sent by informality, which one of our respondents from the EU (Croatia) commented on.

'In my opinion, all formal institutions have employees who are politically selected – in BiH, Croatia, Kosovo – they have the same problem. Those people are not in their positions because of their knowledge, experience, results – there is no criteria there. That is why they need a problem, to pull the brake. Mainly these are stories with ethnic

background, politically motivated – is someone left or right?, was someone a partisan or not?, was someone in the secret service (UDBA) or not?. They are telling us stories and poisoning us with these silly ideas. Actually, my conclusion is that political institutions, these formal ones, are mainly politicized, hence, biased in their structure. In contrast, informal institutions are built naturally, from the ground'. (CRO_4)

Finally, assuming that informal networking is not free, an increase in the number of members in a network could be associated with a higher total cost of networking. We investigate this possibility by looking at the simple correlations between these influences. The pairwise correlation between the two variables – the cost and size of the networks – is indeed positive (0.09) and statistically significant (p -value=0.000). Accordingly, we have indications that a larger network size is associated with a higher informal networking cost, although this needs to be checked in a model with causal relationships to get more meaningful explanation.

Policy Implications

This chapter provides empirical evidence that informal networking is widely used in the WB region. It plays an equally important part in the everyday life of people and in the daily business activities of entrepreneurs. Survey participants report to have around 13 active members in their informal networks and they spend around 100 Euros per month in terms of the money and time they invest. We find evidence that the costs of invested time are a bit higher than what average individuals pay in terms of money. This applies to the both randomly selected citizens and entrepreneurs, although entrepreneurs report having larger informal networks (by some 30%) and bigger informal networking costs (by some 60%). We also find evidence that informal networking is rather gendered as male respondents report having bigger networks and larger costs than females.

While the purpose of networking is diverse, our in-depth interviews with entrepreneurs find that informal networking is primarily used to support their business activities – from providing comfort, support, and advice through established networks to making new business deals within existing and expanding networks. What the majority of entrepreneurs

underline is that informal networking eases cumbersome and demanding formal institutions and their procedures.

The conducted investigation implies that policy makers should not look at informal networking and informal practices built in the household and business sector as an exclusively negative phenomenon associated with cultural and traditional backwardness or ethnic and religious roots, representative of the Western Balkans' mentality. Rather, informal institutions, channelled and supported by informal networks and practices on the ground send a valuable signal, serve as indicators of the functioning of formal institutions that need attention, and have the potential to be integrated into policy thinking. As our key policy relevant finding, we establish that individuals in the WB region who invest into informal networking do so at a high cost, which implies that the culturally determined sociability of informal networking has an instrumental purpose.

Policy makers know that informality in the WB business sector, although built and inherited from the past, do respond to the imposed positive changes of formal institutions over a quite short period of time. However, waiting for a complete turnover in the workings of formal institutions without simultaneous engagement with the informal sector is not an option. On the one hand, introducing relevant policies to increase the efficiency of formal institutions and regulations is likely to reduce informality without an additional effort to change culture, traditions, or mentality of people. On the other hand, the champions of change tend to use all available avenues in policy-thinking (Mungiu-Pippidi, 2015).

Exploring the potential of context-sensitive policies and engaging informal practices for policy implementation, and articulating the significant costs of informal networking for people in the WB region can help facilitate change and create shortcuts in post-conflict societies. Thus, for example, through their informal networking entrepreneurs deal successfully with the ethnic and religious issues that present multiple challenges for heterogeneous societies, and much more effectively than the formal institutions. While formal institutions are generally prioritized in policy thinking over informal ones, they are only one part of the solution. The other part will remain to depend on the integration of the well-established informal practices of social inclusion of ethnic and religious differences into formal institutional settings (ALB_1; BiH_2, MAK_2), which brings economic benefits (Efendic and Pugh, 2018). While formal institutions tend to go 'formal' (by issuing legal requirements and constraints) in engaging

with diverse and complex environments in the region and thus send wrong signals to the international and local community, informal networking and unofficial channels provide a back-up and prove to operate effectively on the ground.

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