



REASONS BUSINESS ACTORS AVOID FORMING FORMAL LEGAL ENTITIES

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Abstract

This paper explains why business actors avoid forming formal legal entities by examining normative mechanisms behind organizational choice. The discussion frames avoidance as a decision shaped by perceived costs, legal certainty, and control over operations and information. Key drivers include administrative complexity, time valuation, compliance learning burdens, and concerns about predictable enforcement outcomes. The paper also addresses preferences for personal control, informal dispute handling, and confidentiality of cash flows, margins, and supplier relations. Perceptions of taxation duties and reporting exposure influence willingness to enter formal registries, especially when benefits are seen as distant or uncertain. Market structure matters because some supply chains require legal status for contracting, while others reward speed and low overhead. Institutional trust and communication quality affect legitimacy of rules and perceived safety of interacting with public agencies. The paper distinguishes temporary postponement from persistent avoidance and shows how these patterns relate to business life cycle and internal governance practices. It concludes that formalization decisions are best understood as institutional calculations that combine economic incentives with social norms and perceived procedural reliability.

Keywords: legal entity formation, business formalization, compliance costs, institutional trust, administrative burden, organizational choice, social norms.

Introduction

Business actors conduct economic activities through a choice of organizational forms that determine how they enter into contracts, bear risks, and interact with the state. In corporate legal theory, formal legal entities provide for the separation of assets, limited liability, organ structures, and an administrative trail that can be audited. In practice, some business actors choose to operate without forming a formal legal entity or defer its formation until a certain stage. This choice often appears rational from the actor's point of view, as they weigh costs, uncertainty, and the need for flexibility. When transactions are still based on personal trust, actors may assume that written contracts and corporate structures are not yet urgent. The level of understanding that business actors have regarding regulations is often a determining factor in their awareness and interest in fulfilling business licensing requirements (Mardikaningsih & Arifin, 2021). In small-scale trade relationships, business control often rests on social proximity, reputation, and direct supervision. Meanwhile, the state places the legality of business entities as an entry point for consumer protection, tax compliance, and the certainty of guidance. This difference in orientation creates a gap in assessment regarding the benefits of formal legal entities. This gap in assessment is important to discuss scientifically because it influences the direction of economic formality.

A formal legal entity is essentially a tool for managing responsibility and expanding access (Yohana, 2015). Within a normative framework, legality opens up opportunities for financing, partnerships, procurement, and brand strengthening. However, legality also creates obligations that change the way business actors work, ranging from bookkeeping and reporting to licensing compliance and labor obligations. The implementation of good corporate governance is a fundamental instrument in creating transparency and ensuring business sustainability amidst global market competition (Rojak & Al Hakim, 2023). This change in work methods can be perceived as a burden that reduces agility. Many business actors live in a business rhythm that is highly adaptive, relying on daily cash flow, seasonal demand patterns, and rapidly changing supplier relationships. In such circumstances, formality is viewed as a rigid process that demands time. On the other hand, the benefits of formality are often understood as long-term benefits. This difference in time horizons causes

business actors to evaluate formal legal entities in various ways. Some view it as an institutional investment, while others view it as a diversion of energy from production and sales. This varied understanding underscores the need for a conceptual study regarding the factors causing avoidance.

The choice to avoid formal legal entities is also related to how business actors evaluate legal risks and business risks. Business risks are often seen as something that can be managed through networks, supplier diversification, and price adjustments. Legal risks are understood differently, as they relate to inspections, administrative sanctions, and tax obligations. Some business actors believe that becoming formal means placing themselves on the radar of supervision. When compliance tools are perceived as complicated, business actors judge that formality increases, rather than decreases, risk. Protection of intellectual property rights is a crucial legal aspect for business actors in the digital era to maintain their competitiveness and creative assets (Ramadhan, 2022). At the same time, avoiding formal legal entities can weaken bargaining power, especially when actors deal with large partners that require legality. Therefore, avoidance does not mean that business actors reject growth; rather, actors are choosing a gradual path according to their perception of security. This gradual choice forms an important spectrum for interpreting the causes of avoidance as a series of considerations rather than a single decision.

In many business activities, the form of law is chosen only after the actor feels the need for a more structured organization. This need may arise when transaction scales increase, responsibilities toward third parties grow, or when the business begins to employ a broader workforce. However, before that need is felt, business actors often prioritize cash flow continuity, operational efficiency, and market certainty. Delays may also be linked to uncertainty regarding which type of legal entity is most suitable. Furthermore, business actors often view the establishment of a legal entity as demanding documents and transaction evidence to which they are not accustomed (Karina, 2019). Clarity of authority and legal responsibility for business managers is essential to ensure that corporate governance runs in an orderly and accountable manner (Nugroho et al., 2024). When administrative capabilities are limited, actors perceive a risk of missteps. This risk of missteps may be perceived as more detrimental than the benefits of formality, which have not yet been felt. Consequently, actors choose the

path considered safe: operating the business under a personal identity or through internal family arrangements. This choice confirms that avoidance can stem from different logics of risk management.

Social and psychological factors also shape the attitude of business actors toward formal legal entities. For some actors, personal control over the business is considered a guarantee of quality and stability. Formality may be perceived as a dilution of control. The application of ethical principles in carrying out legal activities is the foundation for maintaining professional integrity and justice for all parties involved (Saktiawan et al., 2021). Additionally, some actors view that legality can create internal conflicts because it demands the division of roles, distribution of profits, and transparent bookkeeping. Beyond that, social experience with bureaucracy influences attitudes. When actors have had bad experiences with public services, they tend to generalize that the process of establishing a legal entity will be exhausting and uncertain. The implementation of effective and community-oriented public services is key to building trust in government governance (Rojak, 2021). This perception shapes the preference for avoidance. Because this study is normative, the emphasis is on the structure of reasons that may be present in the business actor's assessment.

The issue that needs to be explained scientifically is the imbalance between the goals of company law and the behavioral choices of business actors. The law provides tools for business certainty, separation of liability, and orderly transactions. However, some business actors remain committed to informality or semi-formality even though those tools are available. Protection of trademarks at the national and international levels is a legal challenge that requires compliance with regulations to avoid the risk of infringement (Yani et al., 2023). Furthermore, there is a need to strengthen effective business competition regulations to ensure a healthy business climate within the dynamics of cross-border markets (Zulkarnain et al., 2024). This imbalance raises conceptual questions about what actors actually value as costs and benefits. If a formal legal entity is understood as a risk-reduction tool, why is it often viewed as a source of new risk? This issue is important because it relates to the quality of economic governance and transaction orderliness.

Another issue is the diversity of avoidance forms, which are often lumped together as "informality." This diversity shows that the causal factors

are not always the same. Avoidance can also be related to a preference for the confidentiality of business information, such as margins, suppliers, and cash flow. Harmonization of law between national rules and international standards provides certainty for business actors in conducting business activities (Kusuma et al., 2024). Additionally, transparency in public policy management and management accountability are key elements in driving prosperity and development success in various sectors (Rojak & Issalillah, 2022). It is also important to consider how public ethics and professional human resource governance can support administrative effectiveness in the work environment (Rojak, 2024). Thus, the conceptual problem is how to unravel the diversity of causes without oversimplifying the choices of business actors as a single motive.

The objective of this writing is to develop a conceptual description regarding the factors causing business actors to avoid formal legal entities and to explain the reasoning mechanisms underlying such decisions. The description is directed toward mapping categories of causes, such as compliance costs, administrative procedures, perceived enforcement risks, the need for flexibility, control preferences, and the management of business information. This writing aims to clarify the relationship between the choice of business form and the legal and economic consequences perceived by the actors. Theoretically, the writing provides an argumentative structure that integrates the perspectives of corporate law and organizational behavior. Practically, the writing provides a conceptual basis for developing coaching approaches and business formality policy communications that are more accurately targeted.

Method

This study utilizes a qualitative literature review to construct a normative synthesis regarding the reasons why business actors avoid formal legal entities. The sources reviewed include social research methodology books, conceptual works on corporate law, and organizational theories that explain institutional decisions and compliance. Source selection was conducted through an assessment of relevance to the problem formulation, clarity of definitions, and coherence of argumentation. Adler and Clark (2011) serve as a reference for organizing the search process, determining focus, and maintaining discipline in distinguishing

conceptual statements from claims requiring empirical evidence. In this study, the unit of discussion is set on the decisions of business actors regarding the formation of legal entities; thus, the reading of sources is directed toward capturing institutional motifs, cost perceptions, and perceptions of certainty that recur within scholarly discourse. This approach keeps the writing normative without including interviews, field observations, or the presentation of numerical data.

The processing of materials is carried out through systematic reading and thematic coding to group ideas into procedural, economic, institutional, and internal organizational themes. Wellington and Szczerbinski (2007) are used to strengthen the systematic nature of the synthesis, particularly in organizing interconnected themes, writing consistent argumentative narratives, and maintaining the scope of discussion to prevent it from turning into a policy description detached from the research questions. Variations in citation styles are applied appropriately, such as narrative forms like Adler and Clark (2011) and parenthetical forms like (Wellington & Szczerbinski, 2007), with the aim of maintaining the fluency of the sentences. Conceptual validity is maintained through the consistency of terminology, the use of clear working definitions, and the rejection of unjustifiable generalizations. With this method, the research results are presented as an explanatory framework that links the choices of business actors with the construction of norms, governance, and institutional incentives.

Result and Discussion

The formation of legal entities in Indonesia is regulated through a framework that varies depending on the type and purpose of the entity, ranging from profit-oriented to social purposes. The primary foundation for commercial entities rests on Law Number 40 of 2007 concerning Limited Liability Companies, which was subsequently updated significantly through Law Number 6 of 2023, or the Job Creation Law. This latest amendment provides significant flexibility for small business actors through the introduction of the "Individual Company" (Perseoran Perseorangan) status, which allows for the establishment of a legal entity by a single person with more affordable costs and simpler procedures compared to conventional capital-partnership companies. The clarity of

these regulations is a fundamental step in creating a more structured business environment (Darmawan, 2013).

For entities based on the principles of family and people's economy, the regulation for their formation refers to Law Number 25 of 1992 concerning Cooperatives. Through adjustments in the Job Creation regulation, the requirements for establishing a cooperative are now easier, with the minimum number of founders reduced to only nine people for the primary cooperative category (Siregar et al., 2024). This aims to encourage collective economic growth at the grassroots level so that they have a strong legal umbrella to conduct their business activities formally and professionally. The alignment of public policy is essential to maintain a balance between economic interests and social sustainability (Mardikaningsih & Hariani, 2021).

Meanwhile, for organizations focusing on social, religious, and humanitarian fields without seeking profit, their formation is regulated under Law Number 16 of 2001 concerning Foundations, as amended by Law Number 28 of 2004. Unlike companies or cooperatives, a foundation is a legal entity consisting of separated assets and does not have members, so its governance places a strong emphasis on transparency and the certainty of its purpose in serving the community (Anggraini et al., 2022). In addition to foundations, there are also Incorporated Associations (*Perkumpulan Berbadan Hukum*) which still refer to the old provisions in *Staatsblad* 1870 Number 64 as a platform for membership-based non-profit organizations. A deep understanding of organizational ethics is the key to ensuring responsible governance (Darmawan, 2013; Darmawan, 2022).

Technically, the entire process of legitimizing a legal entity's status in Indonesia is now integrated digitally through the General Legal Administration system under the Ministry of Law and Human Rights. The status as an independent legal subject is only considered valid after receiving an official decision from the Minister of Law and Human Rights, which automatically separates the personal assets of the founders from the assets of the entity (Aprinawati & Ginting, 2023). This system integration ensures that the formation of legal entities can be conducted more transparently, quickly, and with equal legal certainty for all scales of business.

The avoidance of formal legal entities can be explained as an institutional decision born from the business actor's assessment of costs,

certainty, and control. In a normative perspective, a formal legal entity offers a set of benefits recognized in corporate law, such as the separation of assets and a structure of representation. However, these benefits come with administrative obligations that require documentation skills, orderly bookkeeping, and compliance with reporting procedures (Agbleze, 2022). Business actors starting operations with limited capital often judge that administrative orderliness is a burden that diverts attention from income-generating activities. This assessment does not necessarily indicate a rejection of the law, but rather a priority on cash flow continuity. Within the framework of transaction costs, an informal choice can be understood as an attempt to suppress coordination and documentation costs in the initial stages. Meanwhile, formality is perceived to expand exposure to audits and sanctions, especially if the actor feels unable to fulfill all obligations. Therefore, avoidance is often preventive, aiming to evade the risk of being judged for violations deemed easy to commit. This explanatory structure shows that the decision regarding legality does not stand alone, but resides within a comprehensive assessment of operational capabilities and rule certainty. The readiness of business actors in facing regulatory uncertainty and managerial challenges is a determinant of future business sustainability (Mardikaningsih & Darmawan, 2021).

Procedural factors are often the initial category that emerges in the reasoning of business actors. The procedure for establishing a legal entity demands a series of steps, identity documents, data entry, and the fulfillment of specific requirements that are perceived as time-consuming (Kasigwa, 2024). In the actor's assessment, time has economic value because it can be utilized for production, marketing, and order fulfillment. When actors feel procedures are difficult to predict, they view there as a risk of wasting time without results. This risk increases if the actor has previously experienced inconsistent public services or services that require repeated visits. Normatively, procedural uncertainty weakens the appeal of formality by reducing the reliability of the process. Furthermore, procedures are often understood as the gateway to subsequent obligations, leading actors to associate the establishment of a legal entity with long-term compliance burdens. In a conceptual explanation, the actor does not evaluate the procedure as a single stage, but as a binding institutional commitment. If that commitment is viewed as not yet commensurate with

the scale of the business, avoidance becomes the choice. Thus, the procedural factor is not merely about complexity, but about the perception of uncertainty and the perception of the subsequent consequences of formality. Often, there is a clash between local values held by society and marketing approaches or formal regulations (Mardikaningsih et al., 2021).

Direct and indirect costs form a strong rationale for avoidance. Direct costs can be understood as establishment fees and support service expenses, while indirect costs encompass the cost of time, opportunity costs, and the cost of adapting work systems (Milliou, 2020). In the early stages of a business, actors often rely on simple bookkeeping and cash management that is mixed with household needs. Formality demands stricter separation, recording, and reporting. This change requires a learning curve and sometimes necessitates professional assistance. Within a normative framework, adaptation costs are tangible because they require a change in habits, not just monetary payments. Business actors who do not yet have administrative staff will bear that burden themselves. If the burden is considered disruptive to the business's core focus, the actor judges that a formal legal entity increases operational costs. Furthermore, actors may judge that compliance costs do not produce directly perceptible benefits, especially if their market does not require legality. The assessment of delayed benefits makes costs appear heavier. Thus, avoidance can be explained as an effort to maintain short-term efficiency at the expense of long-term institutional benefits that are not yet considered relevant. In franchise or partnership systems, the ethical foundation between the franchisor and franchisee also largely determines the success of business performance (Putra et al., 2022).

Perceptions regarding legal certainty and consistent enforcement also drive avoidance. Business actors evaluate whether rules are clear, whether compliance standards can be understood, and whether the assessment of violations is predictable (Hirtenlehner & Wikström, 2017). If actors perceive that rule interpretation can change or depends on the evaluator, legality is seen as increasing risk. In such circumstances, actors prefer to remain informal because they feel their space for maneuver is safer, even though informally, there are other risks. Avoidance may also be related to concerns over inspections deemed disruptive to operations, such as requests for documents that are difficult to satisfy due to minimal

recording habits. Actors who rely on cash transactions and personal relationships often feel unprepared to face administrative proof standards. Normatively, this concern highlights the gap between the design of obligations and compliance capacity. When that gap is large, actors prefer to avoid rather than face potential administrative errors. Avoidance becomes a form of risk management—that is, avoiding situations that could yield official consequences. This explanation places certainty as a key factor because certainty enables actors to assess the correct steps. Without perceived certainty, formality loses its appeal. A lack of understanding regarding obstacles in filing legal lawsuits, for instance related to copyrights, often triggers a reluctance for actors to deal with the formal realm (Hardyansah et al., 2021).

Operational flexibility often occupies an important position in an actor's decision-making. Businesses that rely on daily orders require quick decisions regarding pricing, suppliers, and schedules (Wang et al., 2021). Actors may view that a formal legal entity adds layers to decision-making, such as the need for specific approvals, separation of roles, or internal provisions that limit improvisation. Although formal structures can be designed to be flexible, the actor's perception often labels them as binding structures. Furthermore, formality is perceived to increase "exit costs"—the difficulty in stopping or changing a business when market conditions shift. Actors who frequently switch product lines may judge that formality reduces the ability to adapt. Within a normative framework, flexibility is an economic value that influences institutional choices. If an actor judges that the benefits of limited liability are not yet urgent, then flexibility wins. Avoiding a formal legal entity becomes a way to maintain the ability to pivot quickly without obligations deemed to be permanent. This explanation is also related to the business life cycle stage. In the initial stage, flexibility is often the priority; in the growth stage, the need for structure may increase. This study emphasizes that avoidance can be temporary, yet its causes still need to be explained as part of the actor's institutional logic.

Personal control preference is an internal factor often overlooked in legality discussions. Many businesses are built as family enterprises or based on personal trust (Hough & Turnbull, 2006). In such structures, control over cash, procurement, and strategic decisions is centralized in one person

or family. Formal legal entities are perceived as carrying obligations of role division and information disclosure to third parties, especially if partners are involved. Actors who wish to maintain full control may choose to remain informal so that decisions do not require negotiation. Normatively, control preference is linked to the risk of internal conflict. Formality demands clarity of contribution, profit sharing, and oversight mechanisms. This clarity can surface disputes that were previously hidden. For actors, avoiding a formal legal entity can be seen as a way to maintain group harmony, although this method may delay the resolution of governance issues. Avoidance can also arise because actors wish to maintain the freedom to use business assets for personal needs, which is restricted by the principle of asset separation in legal entities. Thus, personal control preferences and asset management habits are part of the cause of avoidance. This conceptual explanation is important because it shows that avoidance is not always related to monetary costs, but to power structures and internal norms within the business. Furthermore, challenges of social integration and nationalistic dynamics often influence the perspective of business actors in viewing authority and prevailing rules (Fariz, 2021).

Management of business information is a factor that reinforces the choice of informality. Business actors often consider information regarding margins, suppliers, customers, and cash flow to be assets. Formal legal entities demand more orderly bookkeeping and specific reporting, making some information easier to request during audit processes (Rahou & Taqi, 2021). While reporting is not always public, actors may still feel that formality increases openness. Within a normative framework, a sense of information security influences institutional decisions because information is related to competitiveness. Actors who survive through specific supplier networks may fear losing their position if information is dispersed. Furthermore, formality can make it easier for other parties to file claims because an audit trail clarifies contractual relationships. For actors accustomed to informal resolution, increased transaction traceability can be perceived as an increased risk of disputes. This perception drives actors to keep transactions at a personal and verbal level. On the other hand, this choice can reduce the actor's ability to prove their own rights when a dispute occurs. However, the actor's assessment is often more focused on the immediate visible risks—namely audits and claims—

than on the long-term benefits of documentation. Thus, information management is a conceptual factor explaining why some actors view legality as a threat to confidentiality and control.

Access to support services and administrative literacy influence readiness to become formal. The establishment of a formal legal entity and post-establishment compliance require understanding terminology, the ability to fill out documents, and the ability to manage bookkeeping. Business actors strong in production and sales competencies are not necessarily strong in administrative competencies. Within a normative framework, this competence imbalance creates learning costs. If learning costs are perceived as high, the actor chooses to avoid. Furthermore, access to quality guidance can be uneven. Actors who do not know the service path will view formality as an alien territory. Feeling like an outsider increases the perception of risk. In conceptual explanation, literacy is not merely the ability to read rules, but the ability to translate rules into realistic work procedures. If the actor cannot translate them, they feel vulnerable to making mistakes. That vulnerability drives avoidance as a way to protect oneself from consequences. This explanation does not require numerical data to be understood, as it follows the logic of compliance capacity. Limited capacity makes obligations seem threatening, so actors choose the path considered safe. Therefore, administrative literacy can be positioned as a causative factor that mediates the influence of procedures and costs. Consequently, adequate administrative literacy becomes an absolute prerequisite in the effort to transform from an informal business scale to a legal entity (Mardikaningsih & Darmawan, 2021; Mardikaningsih et al., 2021).

Taxation factors often emerge as reasons forming tension between formality and actor preferences. Legality is perceived as being related to tax obligations, reporting, and the potential for audits (Walker-Munro, 2021). Some actors judge that entering the tax system means bearing burdens that reduce margins, especially when selling prices are difficult to adjust. This assessment can be reinforced by a lack of understanding regarding available schemes, leading actors to imagine tax burdens as always being heavy. Taxpayer awareness and the application of appropriate sanctions have a significant influence on the level of compliance and individual satisfaction in fulfilling tax obligations

(Anjanarko, 2022; Masithoh & Mardikaningsih, 2022). Within a normative framework, the perception of tax burdens influences institutional decisions because it relates to business sustainability. Furthermore, actors may judge that taxes are not commensurate with the services received, leading to a sense of injustice. A sense of injustice can reduce the willingness to become formal. At this point, the avoidance of a formal legal entity can be an expression of distrust toward the exchange between obligations and benefits. The utilization of effective information technology and tax education plays a vital role in increasing overall taxpayer awareness and compliance (Lestari & Sinambela, 2022; Lestari et al., 2021). Although such assessments are subjective, normative studies can explain that compliance decisions are often influenced by perceived legitimacy. If legitimacy is low, actors choose to avoid. The application of self-assessment systems and tax technology needs to be continuously evaluated to minimize tax avoidance practices (Sinambela & Putra, 2021; Rimadhani et al., 2024). Thus, taxation factors can be understood as a combination of economic calculations and normative judgments about justice. The public response to tax incentive programs such as penalty forgiveness also shows a close link between public policy and taxpayer behavior (Darmawan, 2021; Sudja'i & Darmawan, 2021).

Employment relationships and labor obligations can form a rationale for avoidance, especially for actors who rely on family labor or daily wage workers. A formal legal entity is perceived to clarify the status of employment relationships and increase administrative obligations, such as record-keeping, safety standards, and specific obligations related to worker protection. Some actors believe these obligations increase fixed costs and reduce the flexibility to manage labor according to demand fluctuations. Within a normative framework, such concerns show that actors view formality as a trigger for changes in cost structure. Furthermore, informal employment relationships are often understood as those built through trust and reciprocity. When formality enters, such relationships can transform into more rigid contractual ties. It is important to understand that formal agreements in business practice are part of the social contract underlying professional relationships (Da Silva et al., 2022). This change can trigger conflict, especially if work rules have historically been managed verbally. Business actors who prioritize social harmony may choose to avoid formality

so that work relations remain fluid. However, this choice carries the risk of weaker worker protection. This study does not offer solutions but affirms that the rationale for avoidance can stem from established work relation structures. Thus, employment becomes a category of causes that must be unraveled in discussions of formal legal entity avoidance.

Financing factors and credit access form an ambivalent assessment. Normatively, a formal legal entity can increase credibility and access to financing. However, business actors may judge that formal financing brings additional obligations, such as collateral, financial reports, and strict repayment targets. If actors already have informal capital sources, for instance from family or networks, they may judge that the benefits of formal financing are not commensurate with the information disclosure and payment discipline required. The integrated use of business capital, education levels, and technology is proven to increase business income significantly (Sinambela et al., 2021). In conceptual explanation, actors compare two regimes: an informal financing regime based on trust and a formal financing regime based on documents. The document regime requires higher administrative capacity and cash flow stability. If stability has not been achieved, actors avoid the formality that serves as a prerequisite for financing. Furthermore, actors may judge that formal credit increases the risk of litigation or aggressive collection actions. Additionally, cost behavior and break-even point analysis are crucial factors that business actors must understand to control operational costs (Sinambela & Djaelani, 2022; Sinambela et al., 2022). Fear of these consequences influences institutional decisions. The sensitivity of micro-business investment to changes in credit interest rates is also often a primary consideration in financial decision-making (Sinambela & Mauliyah, 2017). Thus, financing access does not always drive formality. It can become a reason for avoidance if the actor views formal requirements as a source of pressure and unwanted transparency.

Considerations regarding liability and personal risk can cause an avoidance that appears paradoxical. Theoretically, a formal legal entity offers limited liability. However, business actors may assess that this protection is not absolute, especially when personal guarantees, debt obligations, or governance errors are involved (Sparkman, 2015). Actors who do not understand the limits of this protection may consider the

benefits of a formal legal entity to be unreal. Furthermore, asset separation requires discipline. Actors accustomed to mixing business and household cash may find this separation difficult. This difficulty creates the risk of violating corporate principles, which could lead to the piercing of the corporate veil. Within a normative framework, a lack of understanding regarding liability limits causes actors to underestimate the benefits of formality while exaggerating its risks. Actors then choose the personal path, feeling that they at least understand their own risks. Compliance with financial transparency and tax reporting regulations is a legal obligation that must be enforced to maintain corporate integrity (Parji et al., 2024). This explanation demonstrates the importance of subjective understanding. Institutional decisions are determined by what the actor believes, not merely by what is available in theory. Therefore, knowledge regarding the function of a formal legal entity can be an indirect cause. When knowledge is limited, actors do not see a strong reason to change. Thus, corporate legal literacy becomes an explanatory factor that complements economic and procedural factors.

Relationships with business partners and market requirements also shape decisions. In some supply chains, the legality of a formal legal entity becomes a prerequisite for supplying, participating in procurement, or establishing long-term contracts (Belikova et al., 2020). Under such circumstances, the market encourages formality. However, in markets based on cash transactions and personal relationships, legality is not considered important. Actors operating in the latter markets will assess that formality does not lead to increased revenue. Proper marketing mix strategies and brand positioning are critical in determining the sustainability of micro-enterprises amidst competition (Hariani & Mardikaningsih, 2013; Wisnujati et al., 2014). Within a normative framework, legality is viewed as a tool to access specific markets, not an end in itself. If actors do not target markets that require legality, the incentive for formality decreases. Business development based on local identity and quality control are also important strategies to ensure business sustainability with limited resources (Hariani et al., 2015; Mardikaningsih & Hariani, 2015). Furthermore, actors may judge that formality actually increases price burdens, causing them to lose competitiveness in price-sensitive markets. Conceptually, this

demonstrates the relationship between market structure and institutional choice. The cognitive strategies of entrepreneurs are essential in responding to radical uncertainty in the market (Mardikaningsih & Darmawan, 2014). Actors choose forms that maximize agility according to market demands. If the market prioritizes low prices and speed, the actor will minimize compliance costs. If the market prioritizes standardized quality and audits, the actor is driven to become formal. Thus, the market factor is a category of causes that explains the variation in choices between sectors. Normative studies link this variation to the incentives and contractual norms applicable in each respective market.

Trust in institutions and experiences with public services can influence the willingness to become formal (Williams & Windebank, 2021). Business actors assess whether institutions act consistently, whether procedures are transparent, and whether disputes can be resolved fairly. When trust is low, actors tend to avoid formal interaction because it is perceived as being full of risk. The risks in question can take the form of hidden costs, additional requests, or unequal treatment. Within a normative framework, trust influences the legitimacy of rules. Low legitimacy makes compliance appear as an act that harms oneself. Actors then choose the informal path, which is considered more predictable through networks. Networks provide a sense of security because they are supported by reputation, whereas institutions are perceived as distant. This explanation shows that avoidance is not always related to profit alone, but to a sense of security. When security is absent in the formal path, actors seek it through personal channels. It is important for business actors to realize that the contribution of the MSME sector through economic value mechanisms has a strategic role in poverty alleviation efforts (Wisnujati & Mardikaningsih, 2021). This explains why legalization programs that emphasize economic benefits can be less effective if institutional trust is not addressed. Normative studies position trust as a mediating factor between procedures and decisions. The same procedure may be accepted by an actor who has trust but rejected by one who does not. Thus, trust is a conceptual factor that must be included.

Information asymmetry between the state and business actors can reinforce avoidance. Business actors often do not know the sequence of steps, the documents required, and the legal consequences of choosing a

business form (Cuff et al., 2020). When information is not easily accessible or is delivered in complex language, actors rely on word-of-mouth from their networks. Network information is often selective and tends to emphasize negative stories, thereby increasing the perception of risk. Within a normative framework, information asymmetry creates information search costs. These costs influence decisions because actors must choose whether to allocate time for learning or to continue operating as usual. If the benefits of learning are not yet clear, actors delay. Furthermore, inconsistent information between sources enlarges uncertainty. Uncertainty makes actors choose the status quo. The status quo in this case is the informality that is already understood. This explanation emphasizes that avoidance can arise from the inability to build a map of obligations. Without a map, formality appears as a territory full of traps. Actors choose avoidance as an act of self-protection. Thus, the communication of rules and the clarity of information become conceptual factors in the formation of institutional decisions.

The structure of perceived incentives and disincentives also influences decision-making. Business actors evaluate whether becoming formal provides tangible advantages and whether remaining informal carries serious consequences (Cavotta & Dalpiaz, 2022). When the consequences of informality are rarely felt, actors judge the risk to be low. When the benefits of formality are not visible, actors judge the utility to be low. The combination of low risk and low benefit results in stable avoidance. Within a normative framework, this assessment relates to compliance theory, which weighs the probability of enforcement and the legitimacy of rules. However, the assessment is not always rational in a purely economic sense. It is influenced by stories, friends' experiences, and perceptions of fairness. Actors may reject formality because they perceive that rules are designed for large players, not for small businesses. The role of women in entrepreneurial activities has also been proven to increase economic independence, which indirectly strengthens family resilience in facing market dynamics (Mardikaningsih, 2015). This assessment forms a subtle resistance: choosing not to enter the system. Furthermore, actors may judge that formal incentives are general and unrelated to their needs, such as access to programs that do not match their sector. When incentives are not specific, actors deem them irrelevant. Thus, the perceived incentive

structure is a causative factor. Avoidance can be explained as a response to a structure that is considered not to offer rewards commensurate with the costs and risks of formality.

Social norms within business communities can also affect decisions. In some environments, operating a business personally is considered natural and is a hereditary habit (Lee et al., 2017). Such habits establish a standard of normality. When the standard of normality is informality, actors who choose formality may be perceived differently or even viewed with suspicion. Suspicion can be linked to concerns about taxes, professional jealousy, or fear of scrutiny. Within a normative framework, social norms function as a mechanism for reinforcing behavior through community acceptance and rejection. Actors who wish to maintain social relationships may follow community norms. Furthermore, social norms can influence how actors understand risk. If the community views formality as a source of problems, the actor adopts that judgment. This explanation shows that institutional decisions are not always individual; they are influenced by social expectations. In network-based businesses, social expectations are very strong because suppliers and customers often come from the same environment. Actors may worry that formality will damage personal relations. Although such concerns are not always accurate, they can be strong enough to encourage avoidance. Thus, community norms and reputation become categories of causes that explain avoidance without referring to field data.

The complexity of choosing a business entity form can be a factor that hinders formality decisions (Abate et al., 2018). Actors must select the appropriate form, understand the consequences of asset separation, comprehend organs and authority, and grasp reporting obligations. If the available information is technical, actors find it difficult to compare options. This difficulty creates the risk of a "wrong choice"—a cost of expectation, which is the imagined cost that would arise if the decision were mistaken. Risk-averse actors tend to delay until they are certain. This delay can last a long time because actors are busy with operations. Furthermore, actors may judge that changing the form later will be complicated, making them reluctant to start. This explanation shows that avoidance can stem from the uncertainty of the choice, not from a rejection of formality itself. Actors may intend to be formal but are waiting

for what they consider the right time. Within an institutional framework, this is a timing choice rather than a value choice. However, during the delay, actors remain outside formal protection. Thus, the complexity of choosing a business entity form must be understood as an independent causative factor that interacts with administrative literacy.

The relationship between avoidance and dispute management also needs to be explained. Business actors often resolve disputes through informal negotiation and compromise. They may judge that formal mechanisms are slow and expensive. A formal legal entity is perceived as binding actors to formal mechanisms when conflicts occur, as there are more documents and claims are easier to construct. This perception makes actors choose informality so that the space for negotiation remains broad. Within a normative framework, the preference for informal resolution shows that actors evaluate the cost of disputes as an important factor. They want to avoid channels that are thought to increase the escalation of conflict. However, this choice can weaken the protection of rights in the long term because transaction evidence is minimal. Actors place more emphasis on the stability of relationships than on formal certainty. This explanation positions avoidance as a choice of conflict governance. Formality is viewed as increasing the formality of disputes, whereas informality is viewed as maintaining flexibility. Furthermore, actors may worry that formal disputes will invite inspections into other aspects, such as taxes and permits. This fear adds to the reasons to avoid. Dispute resolution of tax issues related to transfer pricing also poses its own challenges for companies, which must have strong transaction evidence (Triyono et al., 2024). Thus, the preference for dispute resolution mechanisms becomes a causative factor that interacts with institutional trust.

The business growth stage factor provides an explanation for why avoidance often occurs at the beginning and then decreases at a certain stage (Tarizadeh & Chen, 2021). At the initial stage, actors focus on proving their products and finding customers. Legality is viewed as administrative work that does not yet generate sales. As the business grows, the needs for financing, contracts, and asset protection increase. At this point, actors begin to see the benefits of formality. Within a normative framework, the growth stage influences the structure of perceived benefits. The benefits of a formal legal entity become relevant when the cost of risk

increases, such as when transaction values are large and when potential claims increase. However, not all businesses reach that stage. Some businesses remain small and survive through flexibility. For such businesses, the benefits of formality may remain distant. This explanation shows that avoidance is not always a problem, but rather the result of a staged calculation. However, from the perspective of economic order, avoidance can complicate consumer protection and risk mapping. Therefore, normative studies need to acknowledge the variation in stages and the variation in business goals. Actors who do not intend to expand the market will evaluate formality differently than actors who want to partner with large institutions. Thus, the growth stage becomes a factor that moderates the influence of cost and procedural factors on decision-making.

Regulatory design factors and service integration can also shape avoidance. When obligations are spread across many channels and require the repetition of documents, actors judge the system to be unfriendly to business (Aswar et al., 2020). Within a normative framework, regulatory design that demands many steps increases transaction costs. High transaction costs influence institutional decisions. Actors then choose the informal path, which is considered simpler. Furthermore, inconsistencies in terminology and definitions between regulations can cause confusion. Confusion leads to uncertainty. Uncertainty leads to delay. Delay ultimately becomes prolonged avoidance. This explanation remains normative because it assesses the relationship between the design of rules and the behavior of business actors without presenting empirical measures. Furthermore, actors may judge that the updating of rules occurs too quickly, making it difficult to follow. Rapid change increases the cost of learning. If the cost of learning is not commensurate with the benefits, actors avoid it. Thus, regulatory design and the dynamics of changing rules become causative factors. This factor interacts with literacy, trust, and administrative capacity. For actors with low capacity, changes in rules feel heavier. This explains why avoidance can be concentrated in specific segments. This study positions rule design as part of the structure of causality.

The avoidance of formal legal entities can also be understood through institutional theory, which suggests that choices are influenced by

normative, mimetic, and coercive pressures. Normative pressure stems from professional communities and associations that encourage standards of legality. Mimetic pressure emerges when actors imitate successful competitors. Coercive pressure arises from contractual requirements or enforcement. Within a normative framework, when coercive pressure is weak and normative pressure is not strong, actors tend to stick to familiar forms. When mimetic pressure arises—for example, seeing partners reap the benefits of legality—actors begin to consider changing. However, change still requires capacity and access to services. If capacity is lacking, pressure does not result in action. This explanation helps in understanding variations between sectors. In sectors connected to procurement and audits, coercive pressure is strong, and formality increases. In sectors based on cash and networks, pressure is weak, and avoidance persists. Thus, the causes of avoidance can be mapped as a combination of low pressure and high costs. This map allows for a more organized discussion than simply stating that business actors are reluctant to comply. Normative studies also underscore that actors can move from informal to formal when pressures change. This movement explains why avoidance is not a fixed status, but rather the result of dynamic incentive structures and norms.

From the internal side of the business, simple governance is often a strong rationale. Business actors who manage their own businesses feel that direct supervision is sufficient to prevent misuse. Formal legal entities are perceived to add unnecessary oversight procedures. Within a normative framework, this shows a difference in paradigms. The personal paradigm emphasizes control through presence, while the corporate paradigm emphasizes control through systems. Actors who are successful with personal control find it difficult to see the benefits of a system, especially when the scale is not yet large. Furthermore, actors may fear that a system will reduce their speed in making decisions. This fear becomes a psychological barrier. Normative studies can explain that speed and control are values highly prized by actors. If formality is considered to reduce both, avoidance occurs. Additionally, actors may judge that corporate systems demand new skills such as conducting meetings, keeping minutes, and documentation. These new skills are perceived as non-productive work. This explanation positions avoidance as a reaction to changes in work culture. Actors must change how they

lead, how they assign tasks, and how they evaluate. If changing work culture feels burdensome, actors choose to persist with what they know. Thus, internal governance and work style preferences become important categories of causes.

Reputational risk factors can also influence decisions. Business actors may judge that becoming formal means their business identity is easily tracked. When an identity is easily tracked, failures to fulfill orders, customer complaints, or conflicts with suppliers can spread more easily and stick to the business name. For actors operating in tough markets, reputational risk is viewed seriously. Within a normative framework, actors who want to experiment with products and markets may choose informality so that failures do not leave an institutional trail. An institutional trail is perceived to "lock in" a reputation. Furthermore, actors may worry that formality makes the business more vulnerable to becoming a target of unfair competition, such as being reported. This concern returns to trust and perceptions of enforcement. If actors believe the system is fair, they are not afraid of being reported. If they do not trust it, they avoid it. This explanation shows the relationship between reputation, competition, and formality. Actors who are in markets with sharp competition may view formality as opening the door to interference. Thus, reputational risk becomes a causative factor that enriches the map. This factor is not about monetary costs, but about social and institutional exposure. Normative studies position it as part of a security assessment.

The avoidance of formal legal entities occurs through a combination of procedural factors, compliance costs, perceptions of certainty, the need for flexibility, control preferences, information management, administrative literacy, tax considerations, labor relations, market structure, institutional trust, community norms, and the dynamics of the business growth stage. These factors operate through the mechanism of business actors' assessment of deferred benefits versus immediate perceived risks. When immediate risks are perceived as high and benefits as distant, avoidance becomes a stable choice. When benefits become tangible through market requirements, contractual needs, or the need for asset protection, actors are more prepared to change.

Thus, the answer to the problem formulation affirms that avoidance is not a single motive. It is an institutional decision that follows perceived

structures of incentives, obligations, and trust. This framework allows for a more measurable reading of business actor behavior without moral judgment. This framework also provides a basis for distinguishing avoidance characterized by rational delay from avoidance associated with distrust and uncertainty. Consequently, normative study can serve as a conceptual foundation for policy discussions and assistance based on clearly defined categories of causes. The success of formalization policy implementation ultimately depends heavily on how authorities are able to balance legal obligations with the real needs of business actors in the field (Kusen et al., 2023). The phenomenon of formal legal entity avoidance by business actors must be viewed objectively as a form of rational institutional decision based on the calculation of incentive structures, immediate risks, and the certainty of benefits.

Conclusion

Business actors avoid formal legal entities primarily due to institutional assessments that position procedures and post-incorporation obligations as sources of costs and risks perceived as immediate, while the benefits of formality are perceived as delayed. Avoidance is influenced by perceptions of procedural uncertainty, administrative adaptation costs, the need for operational flexibility, preferences for personal control, and the desire to maintain the confidentiality of business information. Other factors reinforcing the decision include limited administrative and corporate law literacy, perceptions regarding tax burdens, concerns related to labor relations and employment obligations, as well as low trust in institutional consistency. Market structures and partner requirements determine the strength of the push toward formality, while business community norms can reinforce the normality of informality. The developed conceptual framework demonstrates that avoidance is not a single motif, but rather the result of a combination of causal categories operating through mechanisms of assessing benefits, risks, and the control perceived by business actors.

The implications and suggestions emphasize the importance of mapping causes as a basis for designing business formality interventions. Policy needs to treat the establishment of a legal entity as a change in governance; thus, support must encompass the

simplification of steps, procedural certainty, and clear communication regarding consequences and benefits at various stages of business growth. Assistance should be directed toward increasing bookkeeping capacity and the separation of assets, as adaptation costs often trigger avoidance. Strengthening trust requires consistency in service and consistency in compliance assessments so that business actors can predict the correct course of action. Formality incentives need to be positioned as benefits relevant to the actors' needs such as access to contracts, access to financing, and transaction protection using easily understandable language. At the community level, the strengthening of legality norms can be achieved through peer learning among actors who have successfully transitioned, thereby naturally increasing normative and mimetic pressures. With this approach, formality can be understood as a safe and reasonable choice for business actors.

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**Reasons Business Actors Avoid Forming Formal Legal Entities
(Fathoni, M. F., R. Hardiyansah., D. Darmawan)**

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