

# Entrepreneurship

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During the early stages of reform, the government of the Russian Federation and its advisors concentrated primarily on macro-economic stabilisation, perhaps neglecting the importance of small business as a buffer to the difficult process of structural adjustment. Although the number of small and medium-sized enterprises (SMEs) has been growing, filling important gaps as small-scale providers of services and consumer goods, and absorbing some of the redundant resources from heavy industry, small entrepreneurs in Russia are nonetheless finding survival quite difficult.<sup>1</sup>

The historical context provides a partial explanation. The freedom implicit in an economy composed of thriving small firms was incompatible with a planned economic system, and the private ownership they presuppose was, of course, absent in the Soviet system. Moreover, the theoretical background of planned economies was entirely based on economies of scale, in which there was no role for small firms; indeed, the command system would have been even more inefficient if it had to deal with small units.

Compared with other economies in transition, these elements have been more pronounced in Russia and present for much longer. Communism lasted for forty years in Poland and Hungary, and forms of private property continued to exist during that period. In Russia the communist system endured for over seventy years, with much deeper effects on the economic structure and social habits of the country.

The situation in Russia is made more complex by the high degree of informal entrepreneurship, by individuals trying to escape heavy regulations and taxation or simply to survive through the black-market economy in periods of high inflation and recession. Many have started activities that are not registered, and

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are functioning in sectors that lack regulation and where the possibility for intervention by criminal organisations is larger. The general weakness of the rule of law in the Russian Federation is a critical impediment to small businesses which are extremely fragile in even the most robust of economic circumstances.

## How Many Entrepreneurs?

Macro-economic stabilisation and the creation of a positive legislative and regulatory framework might lead to the entry into the official economy of a large number of small firms that are hidden today. The lowest estimate of the size of non-registered economic activities is around 25% of GDP. Other sources put forward much higher figures, up to 50%, possibly employing up to 30 million workers.

In 1990 small firms (mainly in the form of co-operatives) numbered 45,000; by the end of 1991 there were 268,000.<sup>2</sup> The next two years witnessed another considerable increase, up 200% in 1992, and 150% in 1993. From a peak of close to 900,000 in 1994, growth in the number of small firms has slowed since 1995, and stood at approximately 842,000 in January 1997,<sup>3</sup> a low figure for a country of 149 million inhabitants. Poland, with 38 million inhabitants, has more than one million SMEs, and Hungary, with 10 million inhabitants, has more than 500,000 SMEs.

The main areas of economic activity of small enterprises in Russia, accounting for 85% of the total number in 1995, are trade, with 43% of total firms, construction with 17%, manufacturing with 15% and scientific and market services with 10%.

The increase in the number of SMEs in construction has been impressive. The firms involved in this sector displayed a high degree of adaptability in the face of the difficulties of 1994-95, which included decreasing output and high inflation and interest rates. This is especially true in regions such as Kostroma and Novgorod, and in the Altai Republic. As industrial and municipal housing construction activities slowed, these firms developed the construction of private housing (mainly in rural areas) and rebuilding of offices and warehouses.

At the beginning of 1991, only one-third of the small enterprises observed by the Goskomstat

1. Entrepreneurship and Small Enterprises in Russia, OECD, 1998. This and related publications are available free of charge from the OECD Territorial Development Service and on the Internet, at the following address: [www.oecd.org/tels/tdspub.htm](http://www.oecd.org/tels/tdspub.htm).

2. These figures are from Goskomstat, the State Committee for Statistics. Comparability across years on SME statistics is poor, reflecting frequent institutional changes within the Committee and an evolution of methods. Goskomstat is working to improve the data collection concerning small firms.

3. The employment definition of SMEs was modified by Goskomstat in 1996, so that this figure is not comparable with those from 1995 and earlier. The following are the present employment criteria for the number of salaried workers: industrial production, construction and transport: 100 (200 in 1995); agriculture, science, and scientific services: 60; retail services: 30; wholesale trade and other services: 50.

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# in the Russian Federation

were privately owned. By the end of 1993, private establishments already made up two-thirds of the number. In April 1995 only 4% of all SMEs had preserved their state-owned status, including federal and municipal enterprises. And 84% of the remaining 96% of all SMEs are under private ownership, 1% under the ownership of various public organisations, and 11% under mixed ownership.

Russian SMEs are characterised by a large proportion of very small enterprises, with an average number of employees per firm of ten between 1993 and 1995. At the beginning of 1996 nearly 9 million workers were employed full-time in small businesses, 1.3 million part-time and 3.6 million contract workers, making a combined total of 13.9 million. SMEs in industrial production and construction are usually larger (18–20 full-time workers on average), and account for almost 60% of total employment in the SME sector.

The heaviest concentration of SMEs (30.5% of the total) and their employment (28% of total employment in small firms) is observed in the

Central District, with the city of Moscow as the clear leader, followed by the districts of North Caucasus, Ural and West Siberia. Small enterprises are concentrated in the administrative centres and large urban areas.

Since small firms are new to the Russian Federation, entrepreneurs constitute a new social category and their emergence is complicated by the tendency to link them with criminal organisations. Although such organisations are obviously active in the Russian economy, such a link is simplistic and, in many cases, even erroneous. Many honest people in Russia have become entrepreneurs – in western terms – and in a much more difficult environment.

One of the problems most cited by the entrepreneurs surveyed is taxation, a familiar complaint from small entrepreneurs in OECD countries. In Russia, although corporate and individual income-tax rates are comparable to those in other countries in transition, the addition of discretionary regional and local charges makes the real fiscal burden on entrepreneurs particularly heavy. New and constant adjustments

in tax rules, sometimes even retro-actively applied, are common occurrences.

The lack of capital, likewise, renders the creation of enterprises a difficult task, particularly in manufacturing. Entrepreneurs are usually able to cover 15–20% of the initial costs from their personal savings. Less than one-half are able to apply for bank loans, and a very low percentage of small enterprises actually receive credit. The leasing of equipment is in the early stages of development, and credit conditions are very difficult for starting a business: loans are small on average (under \$100,000), with maximum maturities of three months, at market interest rates of up to 150%.

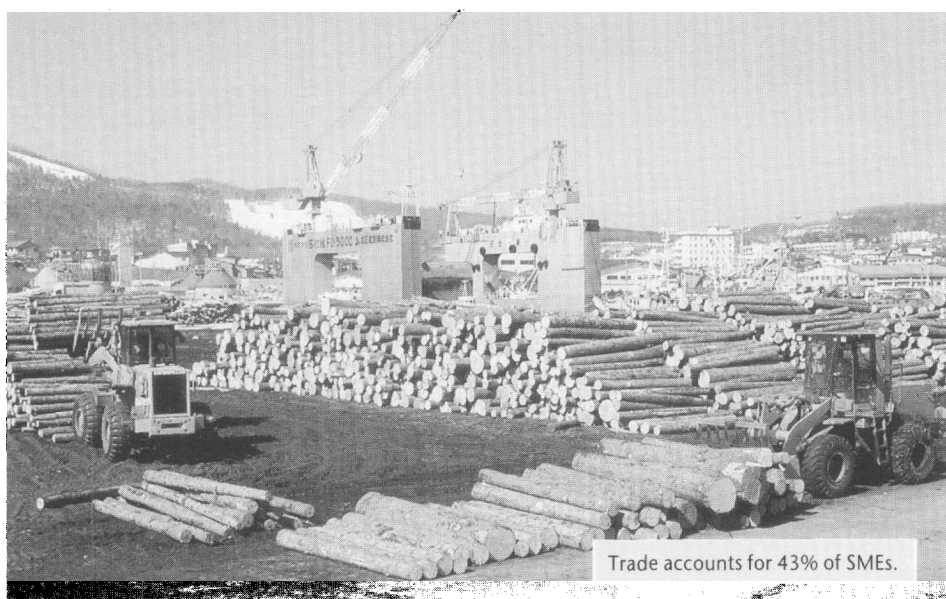
Inter-enterprise arrears also arise from time to time and jeopardise small enterprises. As a result, non-bank high-interest credit and other informal and semi-legal forms of financing are widespread. 'Black' mutual-aid funds (*chernye kassy*) are collected by some enterprises in order to cope with financial difficulties.

The unstable legislative and regulatory framework is yet another of the major obstacles for new entrepreneurs. Property rights, labour relations and many special SME regulations, such as credit co-operatives, leasing and other arrangements, are awaiting legal specification. Such loopholes and lacunae are accompanied by the frequent absence of enforcement mechanisms.

Since the influence of regional and local authorities in the regulation of economic life was high in the Soviet Union, it is hardly surprising that bureaucratic interference into SME economic activities – in the form of barriers and delays, excessive control and reporting requirements, corruption and bribe-taking – is frequently cited by Russian entrepreneurs as an obstacle to their development.

## Supporting the Small Business

The definition of small firms has changed several times in the last five years, as have the ministries and agencies in charge of the implementation of the policies affecting them. The situation was stabilised by the passing of a general





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The growth in the number of SMEs in the construction sector is an indication of its capacity for adaptation.

Law on State Support of Small Enterprise in the Russian Federation in June 1995, and the creation of a new ministerial body, the State Committee for the Support and Development of Small and Medium Enterprises (SCSME), whose task is the co-ordination of all the issues affecting small firms.

According to the Law of June 1995, the Russian Government must submit an SME Support Draft Programme to the Parliament every year before the Federal Budget submission. Federal and municipal SME Support Programmes are supposed to include measures for infrastructure development and SME support on all strata of government, and to integrate vulnerable social groups (disabled, women, young people, retired military officers, unemployed, refugees, discharged prisoners) into the SME sector. They should also include the allocation of budget resources and tax privileges for SMEs; and facilitating access by SMEs to information and new technologies, the purchase of equipment and renting of business premises. The Law also urges the government to allocate not less than 15% of state orders to small enterprises and to encourage SME participation in export and import transactions. The degree of effectiveness and implementation of this set of policies is still unclear.

The 1996-97 Programme for SMEs (co-ordinated by the Ministry of Economy, but actually drafted by the SCSME) includes creating a legislative and regulatory basis for small firms; financial and investment support; supporting infrastructure development; scientific support and personnel training; and social security. Other

priorities are the stimulation of investments (through risk-capital funds set up by regional authorities and leasing of equipment) and the promotion of innovative and R&D business linked to university and research-based towns like Tomsk in Western Siberia. Other central aspects are the transition from federal funding to the principle of variety in sources, with more emphasis on regional programmes and a shift from the direct support of SME projects to the establishment of guarantee funds.

The Programme also aims to develop a minimum infrastructure in every region including SME Support Foundations, banks and insurance companies working in the small-business sector, business incubators, development agencies and training centres, and information networks. According to the initial estimates, the cost of the Programme was 883 billion rubles (\$190 million) – 70% billion from the federal budget and the rest from regional and non-budget sources. Evidence of the implementation of these programmes is scarce, and it appears that much of the work is being undertaken by the regions, for example, through the regional SME Support Foundations and governmental committees in regional administrations established in more than 70 regions to favour enterprise development.

More important in size are programmes funded by international donors. By the end of October 1995, 156 programmes to provide technical and financial support to SMEs had been funded in Russia by a total of 53 donors: governments and international financial organisations and institutions (EU-TACIS, USAID, EBRD and others). Germany, for example, is carrying out

170 projects (at a cost of 75 million DM), 60% of which assist SMEs. These projects vary in length from a month to three years, and it will be a challenge for Russian authorities to sustain these initiatives once the funds from the donors are reduced.

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On paper, the Russian authorities, national as well as regional, have designed a complete set of policies and programmes for the development of entrepreneurship. But the distance from design to implementation is considerable, and the situation differs from region to region. In some cases, especially where high-skilled workers and scientific researchers were available, small enterprise has flourished, at least in relative terms.

International technical-assistance programmes have contributed to raising the awareness of the importance of entrepreneurship in the economy, but their capacity for providing funds is limited. One of the challenges facing donors has been how to design programmes that are appropriate to unfavourable local conditions for small businesses in the Russian Federation. For example, implementing market-based lending programmes is extremely difficult, but creating subsidy-based programmes may contribute to a culture of dependency.

Although Russia has made progress in the creation of a legal and regulatory framework for entrepreneurs, it is not yet enough. The emergence of a vibrant private sector based on small firms in the Russian Federation is a long-term process with which policy dialogue with OECD governments should help. Respect for the rule of law and business ethics will be critical to the survival of new entrepreneurs. \*

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