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## 10 Entrepreneurship and SME policies in fragile environments: the example of Russia

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### INTRODUCTION

Crises mark watersheds in two decades of entrepreneurship development in post-Soviet Russia. These include the systemic crisis of 1990–92, the financial crisis of 1998 and, finally, the economic crisis that has been in progress since autumn 2008. The latter one will presumably be a starting point for new trends in the development of private sector in Russia and for re-conceptualizing government policy concerning entrepreneurship and SME. State authorities in Russia never clearly distinguished between entrepreneurship policy and SME policy, not surprisingly, because even researchers and experts lack understanding of these two approaches. Audretsch (2002) emphasized that SME policies focus on existing enterprises, while entrepreneurship policy also includes potential entrepreneurs, therefore fostering change processes, and paying attention to the overall framework for businesses and aspiring entrepreneurs, whereas SME policy is focused exclusively on the enterprise level.

In a rapidly changing environment, like in Russia during the transition process, government policies to support SMEs and entrepreneurship cannot be explained and understood without a general understanding of the main trends and developments within the SME sector. Therefore, the next section outlines SME development and the main characteristics of small businesses in Russia during the last decade, before the chapter turns to discuss the evolution of SME and entrepreneurship policies since the beginning of transition. In a huge country like Russia the role of regional disparities in SME development and policy approaches of regional authorities becomes crucial and is discussed in the next section. The chapter continues to shortly summarize the role which international programmes and donor organizations played in implementing core principles and institutions of a SME policy in Russia. Finally, conclusions are formulated on possibilities of a new entrepreneurship policy in Russia after the current crisis.

## SME DEVELOPMENT IN RUSSIA AFTER THE 1998 CRISIS

The main aspects of entrepreneurship and SME development in Russia in the early-mid 1990s have been discussed in a number of studies (for example, Black et al. 2000; Centre for Co-operation with the Economies in Transition 1998; Earle and Sakova 2000; Frye 2004; Gaddy and Ickes 1998; Iwasaki 2003; Moers 2000; Murrell 2005; Welter and Smallbone 2003; Yakovlev 2001). Therefore, we will concentrate on a more detailed explanation of the last period in the evolution of small businesses in Russia (1999–2008), because this period has not yet been explored sufficiently in international publications. However, what is more important, without such an observation the shift in the State policy from ‘classical’ SME support schemes towards a more entrepreneurship policy oriented approach would not become clear.

In 1998 the crisis opened new opportunities for the development of ‘free entrepreneurship’, that is, entrepreneurship based on the recognition and use of opportunities rather than on ways to secure rent income after the departure of bigger players from the market. This is particularly true of those small and medium-sized enterprises whose business relied on local resources and was covering demand by the middle class, gradually recovering and growing in numbers. Many of the current Russian *gazelles*, which represent the second or third tier of Russian business (mostly in food processing, clothes and footwear manufacture, business services, IT, consulting) emerged at that time. In the mid 2000s, the percentage of gazelles was estimated at 12 to 15 per cent of the total number of acting ventures, compared to 4 to 8 per cent in developed countries (Yudanov 2008).

In the early 2000s, new developments and trends in the evolution of entrepreneurship in Russia occurred. The increasing wages (+10–20 per cent per year) provided fuel for a fast growth of consumer demand, resulting in a boom in retailing, services and public catering and in a new format, too – there is a multiplication of trade chains, which became the core customers of national manufacturers of basic goods. Additionally, the federal government made a conscious choice in favour of the authoritarian modernization model very similar to the South Korean version of the 1960s and 1970s. A ‘business capture’ by the State led to the growing role of state-owned corporations and their strategic advantages.

In this context there is an increasing tendency towards ‘business capture’ by the State (Yakovlev 2006b). The weakness of civil society and the absence of real political competition and formal regulations for the recruitment of civil servants lead to government agencies and civil

Table 10.1 *SME development in Russia from 2002–07, in per cent*

	2002	2003	2004	2005	2006	2007
Average number of full time employees (without freelancers and external contractors)	14.3	15.0	15.9	16.7	17.8	18.9
Average number of freelancers	34.4	36.6	38.7	39.6	40.5	39.5
Average number of external contractors	21.4	22.6	22.0	22.8	19.8	22.4
GDP share <sup>1</sup>	–	9.8	12.5	12.0	11.6	–
Turnover	–	–	–	26.0	26.3	26.6
Investment	2.9	2.4	3.5	3.3	3.6	3.9

Note: 1. Share of small firms' added value at GDP in market prices.

Source: Rosstat (2008), Table 1.1.

servants becoming ever more noticeable in their drive to use their office of regulators and overseers to secure rent incomes. This results in corruption acquiring a new dimension: isolated bribes and gifts develop into a system of contractual relationships between business and bureaucrats. The problem has become so urgent that it is targeted by a special plan orchestrated by the new president Dmitry Medvedev himself.

But the dynamics of small business growth in Russia is on the whole positive. For example, the number of incorporated small businesses increased from 1999 to 2008 from 900 000 to 1.34 million, and the number of employees from 6.2 to 11.4 million. (Nabiullina 2009).<sup>1</sup> According to official SME statistics for 2007–08, however, no significant upward trend in small business development appeared in the pre-crisis period (Table 10.1). Alternative data, for example, the early entrepreneurship index (TEA), as measured by the Global Entrepreneurship Monitor ([www.gemconsortium.org](http://www.gemconsortium.org)), shows the same tendency for nascent entrepreneurship: whereas in 2006 Russia was ranked tenth from the bottom in terms of this indicator, in 2007–08 it was already the last but one out of the 42 countries surveyed. In other words, the share of owners of small business start-ups in Russia in the employable adult population was not only very low, with the 2006–08 indicator at 4.9, 2.7 and 3.3 per cent, respectively, but it dropped even lower in the last two pre-crisis years.

It is obvious that, given the faster growth of wages in the non-market sector and the ever higher economic and administrative barriers (especially

the corruption of several inspections monitoring small firms), private enterprise was no longer an attractive alternative for potential entrepreneurs. This fact can only be interpreted as evidence of the business development in Russia being unfavourable for start-ups and even for already established small firms. According to the 'Doing Business 2010' survey of the World Bank, Russia takes the 120th place among 183 participating countries (<http://www.doingbusiness.org/EconomyRankings/>).

## SME POLICY AND ITS ENVIRONMENT

### **Macroeconomic Stabilization Instead of SME Policy at the Beginning of Transition**

The dominating group of the nation's political elite in early 1990s – first of all, the liberal wing of Russia's experts and government officials under Yegor Gaidar subscribed to the World Bank's concept of the 'Washington consensus', that is structural assistance through macroeconomic policies and deregulation measures (Earle and Estrin 2003). However, the advocates of targeted small business support, represented by lobbyists and staff of numerous governmental and non-governmental organizations that are part of the small businesses support infrastructure, disagreed with them. In 1991, this was a result of limited resources and a lack of tools for supporting small businesses, as well as of the fact that in the absence of an established macroeconomic environment any fine-tuning intervention by the state would inevitably misfire. It was decided that formulating effective antitrust policies, backed by privatization, would make it possible to put in place the preconditions *necessary* for establishment of small business at the grassroots level. The conditions sufficient for sustainable growth would be addressed at a later stage.

Privatization was an important institutional precondition for small business emergence, but its implementation and outcomes in the post-Soviet environment were not what had been expected. In the absence of institutions of market infrastructure or legally accumulated private capital, in an environment of high political risks, non-transparent prices for assets to be privatized, and, above all, with no concerted support available from major groups of the civil society, the initial radical concept of privatization, which provided for stricter restrictions on the bidding by so-called 'red directors', could not have been kept without undergoing major changes. Major concessions had to be made to populist interests and allowances for the actual alignment of forces within the society, including the clout of the former economic elite (Black et al. 2000, Radygin 1995). Once the

privatization was completed, private businesses created from scratch did not, in fact, receive any access to the property and other assets of former state-owned enterprises, and the commercial space (offices, workshops and so on) lease mechanism made it to all intents and purposes dependent on the administration of post-privatized enterprises.

### **The Emergence of ‘Traditional’ SME Policy since the Mid-1990s**

From 1994 to 1995 onwards, after a complete change of the government team, a concept for small business support started to be developed. At that time, small businesses seemed to be a fast growing sector, and its protection should be used to solve problems of the labour market and of some specific groups of population such as former officers of the declining Army.

In May 1995 the Federal Law ‘On State support of Small Business in the Russian Federation’ was adopted. The Law identified small enterprises and the basics of government policies towards small business. The Federal Foundation for Small Business Support (FFSES) was appointed to coordinate financial measures for governmental support of small business. At the same time, according to the above mentioned law, the State Committee for Small Business Support and Promotion (SCSESP of Russia) was set up. It was charged with the implementation of government policies in the area of small business, the formation of comprehensive infrastructure for small business support, including consulting, information and financial support, as well as the coordination of the Federal Fund’s activities.

It was during that period that a system of organizations and institutions for the support of small firms was started to be put together both at the federal and territorial levels, including territorial foundations and centres for the support of private enterprise. Until 1998, 73 regional funds and centres of entrepreneurship support were set up, in 44 Russian regions agencies for small business support were established (consulting, audit and so on), 36 business training and information centres, some science parks across the country, as well as legal and accounting/auditing firms, which catered to small business (<http://www.xserver.ru/user/ffpmp/>).

Local tax exemptions were introduced and funds were allocated from local treasuries for the development of a small business support infrastructure. Also, financial support for small businesses was provided at both federal and territorial levels, drawing on the funds of dedicated foundations. However, even the envisaged small-scale funding of the programmes (for example, in the last adopted Federal Programme for 2000–01 it was foreseen to use sources of different federal authorities in order to fund

RUR 120 billion in 2000 and RUR 210 billion in 2001, that is less than EUR 10 billion in total), both on federal as well as on regional level, never was provided in full ('Realisaciya', without year).

Government policies and institutional arrangements for small business support saw continuous changes; and reorganizations and reshuffles took place on a regular basis. For example, the FFSES saw seven CEOs come and go between 1993 and 2002. In 1998, just before the crisis, SCSESP was dismantled, and the functions of small business support were reassigned to the Ministry of Antitrust Policy. The situation being what it was, one could hardly expect consistency in the implementation of practical measures. According to the Law 'On State Support of Small Business' (1995), Russia was to provide support for small businesses through the development and implementation of relevant programmes at federal, territorial and municipal level.

Until 2002 four special federal programmes, as well as over a hundred territorial programmes, had been adopted and implemented. The implementation of federal programmes in the 1990s helped establish an infrastructure for the support of small businesses at the federal and territorial levels, gain experience, review the support practices abroad, and identify best practices.

There was no appreciable effect, however, made by the said programmes to improve conditions for the growth of small businesses as such. Macroeconomic and political risks (like high inflation) undermined the special support measures. Moreover, serious faults manifested themselves in the established system of state-sponsored support for small businesses. They included its orientation towards allocating solely budgetary resources, inadequate recognition of the needs of the entrepreneurs themselves when choosing support measures and tools, low transparency of activities of the organizations involved, and lack of competition for the governance of resources to be allocated. The major fault of federal (as well as of most territorial) programmes was the failure to monitor the results of the implementation of previous programmes; under such preconditions a waste of resources and corrupt practices were usual features of the state programmes and implementing activities.

### **New Agenda: Roots of Entrepreneurship Policy in the Early 2000s**

The very limited results of the policies implemented in the second half of the 1990s caused the renewed government under Putin's presidency to dismantle the bulky, inadequately funded and poorly performing system of small business support organizations. The FFSES was scrapped as early as the beginning of the 2000s, and the functions of think tank for

private enterprise support were transferred from the Ministry of Antitrust Policy to the Ministry for Economic Development and Trade (MEDT). The system of support organizations that emerged in the 1990s in most territories which was merely built on donations from the Federal centre collapsed in most regions as soon as the FFSES was shut down.

The government made a choice to change policies in favour of the World Bank-supported concept of indirect support of economic growth by way of structural reforms because in the conditions of a fragmented and weak state and highly opportunistic behaviour of public officials the effects of tax reliefs and exemptions, subsidies and the like were totally neutralized by rampant corruption (Yakovlev 2006a, pp. 248–50). Moreover, the policy of structural regulation did not target any specific groups in need of focused support, although it prioritized the problems of growing SME. The early 2000s saw the dominance of an indirect support strategy of small entrepreneurs by reducing red tape and lowering the costs of entry and administration of business. According to MEDT estimates, by 2001 red-tape overheads were as high as 5 to 7 per cent of the GDP.

The main idea of the programme developed in 2000–01 ('Long-term priorities of social and economic development of the Russian Federation') regarding small business support, was to diminish state intervention in the economy, abandon excessive bureaucratic regulation in order to ease bureaucratic pressures on businesses and to improve the performance of government agencies in areas where their involvement is absolutely necessary. Core measures included lowering market entry barriers for businesses; eliminating technical barriers for manufacturing enterprises (reform of the standardization and certification system); eliminating excessive and ineffective administrative regulation of business activities; coordinating the actions of federal and territorial government agencies, in particular developing a mechanism to represent the interests of citizens and organizations through self-regulating organizations, statutory separation of the functions of regulatory and oversight agencies.

The government planned to address these tasks based on a package of new federal laws, together with a complete overhaul of the legislation governing business activities. It proved, however, impossible to implement the plan: laws were put in place at long intervals (August 2001 – June 2003); at least two of them were dropped (Law 'On Self-Regulating Organisations' and amendments to the law 'On Consumer Rights Protection'). The 'cleaning-up' of former laws was not completed either. Moreover, the survey of administrative costs of business activities conducted by Russia's think tank CEFIR (2002–07) suggests that the deregulation policy also produced only limited results, if any, although the overall results for 2007 (2000 firms polled from 20 territories in seven federal districts of Russia) revealed a

number of positive changes in some areas of state regulation. For example, the average term of licences has increased, approaching the statutory requirement; a majority of oversight agencies committed fewer breaches of legislation, in particular, they undertook unscheduled inspections on a less frequent basis; the total number of inspections decreased significantly; the incidence of pressure applied by civil servants with the aim to solicit a bribe in the course of registering ownership or lease of properties was much reduced and the transparency of the procedure increased.

However, CEFIR researchers also recorded deterioration in some areas. For example, the increased importance of personal connections for completing the registration procedure casts doubt on the effectiveness of the so-called one-stop; inspections in general and those by tax authorities in particular became more of a problem, compared to 2004; entrepreneurs feel that the situation with competition has worsened (presumably, they refer to the clout of big business used to unfair advantage at the negotiation table) and that corruption has increased (CEFIR 2007).

It is no coincidence that in her first public address on policies for the support of SME in 2008, the newly appointed Minister for Economic Development, Elvira Nabiullina, formulated a number of measures which to all intents and purposes usher in a 'second wave' of the drive to cut red tape for business (Nabiullina 2008). But even earlier, in the mid of the 2000s, as in the aftermath of dismantling the former system a vacuum in the area of support for private enterprise became more and more apparent, the government started to rethink its policies towards small business and entrepreneurship. In 2007, the efforts culminated in a new Federal Law 'On small and medium-sized entrepreneurship in the Russian Federation', which was adopted after being in the pipeline for more than five years in different versions. Its main feature is that it identifies for the first time, in addition to small businesses, micro and medium-sized enterprises. It modifies and supplements the criteria for classification of private enterprise under these categories – these include, in addition to the structure of authorized capital and number of employees, limits on annual revenues. Moreover, the law identifies schemes and forms of governmental support for SME.

However, the law is seriously defective in that it fails to identify the sources of funding for the policies to support SME (the 'old' law allocated – at least on paper – some of the federal fiscal revenues from the privatization of state-owned assets), or the procedure for the selection of SMEs that would qualify for support. These drawbacks significantly impair the performance of this law as a regulatory framework for government policies.

Even before the new law postulated schemes and forms of support for small and medium-sized businesses, work began on a 'Target-oriented

programme for the support of SME in 2005–08'. In spite of the legislation lacking many of the required preconditions (including the status of a 'target-oriented programme' as such and the concept of 'medium-sized enterprise'), the programme introduced principles and mechanisms stemming from the new understanding of both the role of small and medium-sized business and the capabilities and tasks of the state. What was new in the programme is that, first, it focused on crucial target groups in the SME sector. These included innovative firms (the programme provided for access to resources and to facilitate entry into new markets), start-ups (development of expertise and access to resources), and sustainable growing SME (access to new markets and to resources). Other groups of SME were to receive indirect support in the form of legalization (development of the necessary regulatory framework) and assistance in the development of management skills. For the first time ever, some of the measures implemented as part of the programme were aimed at supporting nascent entrepreneurs. In addition, the 'Target-oriented programme for the support of SME in 2005–08' outlined not only the targets, but also indicators which can be used to measure the degree of their attainment.

Finally, the Programme provided a rationale for its basic support principles, namely, decentralization of SME support mechanisms, co-funding (Federation and regions), a combination of entrepreneurship policy in the advanced territories and SME support in economically weaker territories, competition between state bodies and public organizations in the area of SME support, identification and dissemination of best practices, priority support for firms with high growth potential and lowering of exit barriers for less successful SME and incentives for cooperation between small, medium and large businesses.

Of special note is the need for open and transparent implementation of the Programme based on monitoring its progress and a regular evaluation of its performance, including the mechanism of third-party assessment as a means of minimizing the conflict of interest for the parties involved in the development and implementation of the Programme. The programme's initiators insisted on an annual update of the set of measures and funding objectives which was based on the evaluation of its performance in the previous year. In this sense, the concept of the programme was very close to what is meant under a 'six steps' assessment procedure (Storey 2005).

In the course of in-house coordination and subsequent implementation, however, many of the principles formulated for the renewal of the state programme got lost or were seriously distorted. For example, support was withheld for the idea of competition-based selection of an independent company to coordinate the programme's implementation, and the functions were left with the Ministry itself – thus, a conflict of interests

*Table 10.2 Structure of federal budget expenditures and results of the Programme for SME Support in Russia, 2005–07*

Measures	Expenditures (RUR, mln)	Results
Support of business incubators formation	2730	Co-funding of 111 local, municipal and universities-based business incubators
Formation of venture funds	2151	21 funds, market capitalization – RUR 8 400 mln
Co-funding of regional SME support programmes	1593	SME support programmes in 56 RF oblasts and krais co-funded
Formation of guarantee funds	1556	23 funds, market capitalization – RUR 3 300 mln
Export support	170	380+ companies

*Source:* ‘Maly bizness: ot inertsii k innovatsii’ (2008).

was guaranteed. No public hearings were held on its interim stages and adjustments required, if any. There was no public platform organized (not even on the MEDT website) in order to reach out to and inform possible beneficiaries and civil society. Government also failed to arrange a balanced approach to implement the programme as several of the priorities identified received much more funding than other thrusts without any sound substantiation (Table 10.2).

Moreover, setting priorities and defining the next steps in the implementation of the programme for each following year took place behind closed doors of the MEDT. This makes it difficult to ascertain the success of the programme. In any case, the impact of the programme on the dynamics of the SME sector was relatively low, if assessed by official statistics which show that the input of SME in main economic indicators remained more or less stable and very modest (Table 10.1). Meanwhile, the slowest progress was made in supporting new ventures, exporting SMEs and increasing the involvement of SME in public procurement. GEM data for 2006–08 show that Russia still belongs to the group of countries with lowest share of nascent entrepreneurs in the adult population. Moreover, statistical data also illustrate that no significant change was achieved in the modest state of innovative small firms (Rosstat 2009). The share of small firms’ participation in state procurement remains, according to expert estimations, at 1–5 per cent, far under the estimated target indicator of 15 per cent of public procurement turnover.

The outbreak of the economic crisis in autumn 2008 put on hold the

implementation of further mid- and long-term plans. In late December 2008, support of SME was put on the 'List of Priority Measures of the Government of the Russian Federation' as part of its action against the effects of the global financial crisis. In April 2009 a comprehensive and complex anti-crisis programme of the Russian government was adopted, including a list of measures addressed to support SME and entrepreneurship policy. Measures aimed at increasing the lending programme of the federal main agent in the area of financial support for SMEs, Vneshekonombank, to RUR 60 billion and to provide RUR 10.5 billion from the federal treasury to fund the formation of small business start-ups. The latter includes measures such as lending, interest rate subsidies, provision of government guarantees, development of infrastructure such as science parks and business incubators, allocation of grants and implementation of training programmes. Moreover, the government was to provide a law for preferential treatment of small businesses in state and municipal procurement with a minimum quota of SME's goods and services in public purchases of 20 per cent. This measure provides SMEs with extra 800 billion roubles public purchases. Other measures referred to a resolution to lower the charge for power grid connection of low-consumption facilities and real estate funds for SMEs which provide SME with discount and long-term rental rates. Moreover, territories and municipalities are obliged to involve SME in the fulfilment of government and municipal orders and to remove administration barriers to entrepreneurial activities, including restrictions on access to local markets. Additionally, measures have been implemented to reduce the tax burden on SME. Russian regional governments are in their own right to reduce the so-called single tax on imputed income from 15 per cent to 5 per cent. Deregulation measures minimize administrative burdens for start-ups in order to decrease start-up capital. For example, from July 2009 the registration of a small business has become simplified. An entrepreneur only has to inform the government that he or she is starting a new business. Administrative inspections of SME activity in Russia are restricted to once in three years; and any additional inspections have to be permitted by a state prosecutor.

How efficient may the measures proposed be? As for facilitating access to credit facilities, the problem is not so much the level of credit as credit terms and guarantees, on which federal budget allocations have little direct effect, if any. It will naturally benefit SMEs if their power grid connection charge is lowered and they are granted the right of first refusal to buy state and municipal assets which they have been renting for years and which have already been significantly improved. Measures to reduce tax burden – by way of lowering the profit tax – can be important for the few sustainable growing companies, which are still in the black despite

the crisis in progress. However, the share of such successful SME diminished very significantly, whilst the main goal of an anti-crisis protection should be to support those SMEs who are suffering from finance shortage. However, as for the right granted to territories to lower at their discretion the rate of single tax on imputed income, in the context of the territories' rising budget deficit this measure can be regarded as passing the buck to them rather than a real step in bringing relief to small businesses.

Having been portrayed by and large as priorities, the measures can hardly make a significant impact because they have too little focus on different target groups and fail to factor in the pending changes in the structure of the sector of small and medium-sized business (fewer profit-making and fast-growing firms and more 'weak' firms, inevitably rising number of necessity entrepreneurs, and so on).

### **Regional Differences in Entrepreneurship Development and Support Policies**

A major roadblock to the development of SME and entrepreneurship in Russia has been, and remains, its uneven spread across the country, as well as the widely differing degree of territorial authorities' readiness to facilitate the conditions for the development of effective private enterprise. Small businesses are spread across Russia in a very uneven pattern, with several groups of territories identifiable in terms of its development, as suggested by a survey on the development of private enterprise in Russian territories, which was conducted in 2005 by the National Institute of Systemic Research of Entrepreneurship (Migin 2006). The survey identified eight territorial clusters with significant differences in terms of small business development (Table 10.3).

Small business development differs widely between individual territories in Russia as does the gross territorial product. There can be no doubt that these widely different territories need different ways and means regarding small business support policies, based on objectives that differ in terms of complexity, different levels of fiscal capacity, as well as differences in the level of relevant infrastructure development.

Regional differentiation of support policies, however, is hindered by external circumstances. The fundamental changes that took place in the 2000s limited budgetary powers and burdens, thus significantly decreasing the budgetary base of most regions of Russia. The federal and budgetary reform of the early 2000s led to a situation where the territories still had to honour most of their financial commitments, but with their funding sources significantly reduced. The importance of federal co-funding is highlighted by the fact that in only seven Russian territories federal

Table 10.3 Small business development in the regions of the Russian Federation

Indicator	Cluster	1	2	3	4	5	6	7	8
Number of SE per thousand workforce		37.56	12.72	10.41	14.41	8.54	6.07	5.52	6.14
Average SE staff on payroll per thou. workforce		268.62	99.66	99.63	107.79	79.93	55.69	45.16	42.92
Labour productivity per SE (per employee)*, RUR000's		201.27	372.32	329.21	271.48	251.10	228.64	258.86	648.74
Average number of investments into equity per SE*, RUR000's		28.13	141.70	255.28	70.62	97.42	267.42	45.27	96.52
Receipts of STSTS [single tax under simplified taxation scheme] and STII [single tax on imputed income]*, RUR000000's		2771.42	2644.11	1060.91	783.44	478.42	284.46	277.31	272.03

Note: \* With the consumer basket cost factored in for inter-territorial comparison of purchasing power.

Source: Miglin (2006).

transfers amount to less than 5 per cent of the revenues in the consolidated budget, whilst the rest of the 80 territories are subsidized from the Centre to a much greater extent.

Given the current crisis, one cannot expect the governments of a vast majority of Russian territories to be in a position to implement any support measures whatsoever other than cutting red tape. The biggest problem of entrepreneurship and SME policies in times of the crisis is the contradiction between a need in locally targeted and operated policies and the lack of funding abilities (and often adequate concepts) on the regional level.

### **Summing Up: Progress with Government Policies**

Government policies towards SME and entrepreneurship in Russia have passed through a number of periods. In the early 1990s the government followed the concept of the macroeconomic policy to establish main institutions required for a market-driven economy which were at that time considered more important than SME focused policies. In this context, the policy of financial stabilization and privatization aimed at supporting preconditions for any kind of private entrepreneurship in general rather than targeting specific groups of entrepreneurs and firms such as start-ups and high growing SME. From the mid 1990s preference was given to the concept of supporting small firms by measures of a 'traditional' SME policy. Those are efficient under conditions of a balanced macro-, meso- and microeconomic policy in established market economies with a transparent system of efficient state regulating authorities. However, in the absence of any well functioning and recognized institutions, especially at the micro level, and a lack of financial resources, this policy did not have any impact on SME development. During the crisis of 1998, this system of state support for small business began to collapse. Circles close to the government were convinced not only of its inefficiency, 'radicals' complained about the total irrelevance of the small business support concept. As a consequence the pendulum swung back to the idea of entrepreneurship policy instead of SME policy.

By the mid 2000s, government started to realize the need to implement, alongside improving general conditions for business development, a targeted entrepreneurship policy, to provide specific assistance to key groups of SMEs. With the crisis in progress, starting in late 2008 any large-scale support for nascent entrepreneurs is again all but abandoned in favour of fast-response measures.

There are several and recurring mistakes made in the development and implementation of government policies towards SME and

entrepreneurship. This includes, amongst others, a limited involvement of civil society stakeholders in the process of policy development and implementation; absence of comprehensive analysis of policy background, progress and results; the failure to grasp not only the common features, but also the differences between policies to support small businesses (that is, firms) and those to boost the entrepreneurial potential of the society (that is, of persons), the latter being obviously underrated and finally, the absence of policy coordination at the federal and territorial levels.

## THE ROLE OF FOREIGN TECHNICAL ASSISTANCE IN SME AND ENTREPRENEURSHIP SUPPORT IN RUSSIA

The development of government policies for supporting entrepreneurship in Russia, especially in the period of early reforms, was undertaken with support from major Western partners. That included first of all the EU and the USA, international organizations such as the EBRD, the World Bank, the IMF and the IFC, as well as so-called bilateral programmes, which involved bilateral cooperations with most developed countries. Of the 21 foreign donor organizations involved, the most prominent were USAID, the German Ministry for Economic Co-operation, the European Commission and EBRD (FEED).

As of the beginning of the 2000s, Russia has received technical assistance worth more than \$3 billion from a variety of donor organizations, 20 per cent of which (or 2000 projects) was dedicated to supporting and developing small businesses. That included mainly professional training and exchanges, while policy support, consultations and equipment for small businesses accounted for about 10–15 per cent of the total technical assistance. Moreover, technical assistance is unevenly distributed across the Russian territory, with ‘the major portion being gained by the Central and North-Western regions and the Urals region’ (FEED, no date p. 34).

SME support programmes and projects of technical assistance had different thrusts. Some focused on analytical and advisory support for reforms, monitoring business growth and business climate, while others concentrated on institution building such as microfinance organizations and credit institutions, business associations and business networks, business education centres, or offered management and business-related training. For example, the European Commission provided technical assistance, equipment and initial funding for the Moscow Agency of

Entrepreneurship Development and 23 other regional Development Agencies for SME Support. USAID focused on institution building at regional level. It created 19 business incubators, approximately 140 locations of technical aid and its credit lines totalled more than \$600 million (FEED, no date).

Western technical assistance made it possible to quickly gain command of the legal and regulatory framework of developed market economies regarding the development and implementation of relevant policies, institution building, first of all lending and financial establishments, and the formation of a business education system. However, the eclipse of the authority of international financial institutions in the wake of the Asian crisis of 1997 and Russia's default of 1998, as well as the growing political antagonism between Russia and the West caused SME support activities of Western organizations in Russia to be rolled back, starting in the first half of the 2000s.

Moreover, the overall situation had changed: Russia was experiencing sustainable growth in the 2000s, which rendered the model of technical assistance, put in place in the 1990s in an environment where institutions and governmental experiences in implementing and developing market institutions were lacking, superfluous. It was time to move to a dialogue on a peer-to-peer basis which however, proved increasingly difficult to realize because of the mutual disappointment in the aftermath of the turbulent 1990s. Many Western projects, which provided for the implementation of 'best practices' in an environment of 'bad' institutions failed to prevent the emergence of 'crony capitalism' in Russia. The Russian elite, on the other hand, seemed disappointed with the 'unwillingness' of Western organizations to take into consideration the rules (path dependency) and norms (rather informal than written) of a transition economy and with their believe in 'universal' schemes and notions of international financial institutions.

## CONCLUSIONS

Based on the description of SME development, as well as of the small business and entrepreneurship policy in Russia from the late 1990s onwards, we argue that shortcuts of the state policy towards SME and entrepreneurship were unavoidable. The reasons include a lack of adequate institutions (among them, a lack of experience in developing and implementing adequate policy) and strategic failures in selecting policy priorities. During the period of systemic transition, Russia would have been in dire need of an entrepreneurship policy which promoted an

environment for new ventures and thus could have helped to establish a broader stratum of 'productive small businesses'. Instead, the government tried to establish SME policies similar to that in developed market economies during the 1950s–70s. As a result, other – rent seeking oriented – forms of entrepreneurship ('unproductive' or even 'destructive', Baumol 1990) became dominant. Under such circumstances, the 'old fashioned' SME policy was obsolete. It could merely conserve established enterprise structures, namely micro business with little added value creation, predominantly in retail trade and so on, but had no influence on shaping conditions for high growth new ventures. A new agenda from the early 2000s onwards combined traditional SME policies and some important entrepreneurship policy measures. However, the agenda was still implemented in the old bureaucratic manner with no transparency, no feedback from the SME sector, no monitoring according to clearly defined criteria. Therefore, it did not lead to a fundamental policy change. Moreover, in 2008, after the last SME promotion programme was completed, the crisis occurred, resulting in reactive instead of proactive approaches to designing policies and support.

The chapter shows that in Russia, the strategic objective of government policies must be to support productive entrepreneurship and limit the options for rent-oriented or even parasitic growth of unproductive or destructive entrepreneurship. But this task must be recognized by governmental authorities. Moreover, it involves fundamental changes in the system of ownership rights and the entire structure of social relations, because the domination of unproductive and 'destructive' entrepreneurship is inseparable from the system of ownership power, which disguises itself as the system of private ownership and resists eradication. While mostly entrenched in the segment of the so-called super large and large business, unproductive and 'destructive' entrepreneurship is actually rooted in close personal ties of business owners and managers with the ruling political elite. An alternative is 'productive entrepreneurship', which is mostly based in the segment of SME. However, it is forced to put up with the government's veiled attempts to gain control and is not free itself from opportunistic behaviour patterns. Nevertheless, the sources of its income are still based in a different area – in the area of realignment of market resources for the production of new benefits. Under such circumstances, traditional SME policies providing support for any kind of private enterprise do not undermine the positions of unproductive and 'destructive' entrepreneurship. On the other hand, entrepreneurship policy, focused on providing advice and help for starting 'productive' businesses can foster the consolidation of the latter.

Overall, SME policies in Russia have never been consistent, penetrating or comprehensive in their nature as this would contradict the interests of principal beneficiaries of abortive reforms in Russia. Hence, to outline and conduct a balanced entrepreneurship policy, a sufficiently strong coalition to support such policies is needed. The groundwork for such a coalition to be put together needs the involvement of ‘productive entrepreneurship’, new professionals (since the value of knowledge will inevitably depreciate if dominated by unproductive and destructive entrepreneurship), new regional leaders (because they have no potential allies or sources, other than SME, for fuelling the social and economic development of the territories under their jurisdiction), and the – at least – tacit consent of the nation’s leadership (because the ambitious goals set by it for the innovation-oriented economy under development cannot be achieved as long as Russia is dominated by unproductive entrepreneurship).

The current crisis seems to be a long one, and the measures announced by the federal government to promote SME and entrepreneurship appear to have little impact on SME and entrepreneurship development and especially on the motivation to establish new ventures. Changing the currently dominating inconsistent agenda for entrepreneurship policy is obviously required to create better preconditions for public supported policy which would be in favour of productive entrepreneurship.

## NOTE

1. Note that in Russia up to the 2008 statistics have been gathered for *small* and *incorporated* firms only; the number of sole traders, according to the census of 2007, amounts to 2.5 million.

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