
MICROENTERPRISE IN RUSSIA DURING ITS ECONOMIC TRANSITION, 1991-1993

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Abstract

Small business formation and development during Russia's transition from a centrally-planned economy under totalitarianism to an unregulated economy under democracy has not been widely studied. This study looks at entrepreneurs who started microenterprises in Nizhny Novgorod, Russia, during 1991 to 1993, the early years of transition to determine their need for capital and technical assistance. Study findings suggest that these fledgling capitalists could have used loans from microcredit programs, if not small business loans from banks. But, these entrepreneurs had little need for technical assistance for any aspect of their business. Rather they preferred and had access to private accountants, business assistance and legal advice.

Introduction

Microenterprise programs began in developing countries--Asia, Africa and South America--as an alternative or supplement to development aid that focused on large infrastructure projects, trade credits, loans and military buildups. Microenterprise programs eventually spread to developed countries as a way to help poor people become economically independent. In the past few years, microenterprise programs have been established in Eastern European countries to assist entrepreneurs in making the transition from

communist command economies to democratic capitalist alternatives (OECD, 1996). Now, Russia and its former Soviet Republics have microenterprise programs in place.

Although capital and technical assistance needs of small business in developing countries, developed countries, and Eastern Europe have been well-documented through scientific research, very little is known about small enterprises in Russia in the early stages of its political/economic transition. Most material on Russia comes from anecdotes (Melvin, 1991; Kvint, 1993) or surveys of larger firms (Webster and Charap, 1993; Richter and Schaffer, 1996). Failure to document microenterprise development during political/economic transitions may lead others to misperceive needs and responses in the future.

In the early stages of transition, 1990 to 1993, Russia presented a variety of problems unique among developed countries, and to some extent even more extreme than Eastern European countries undergoing similar change (Buss, in press; Boyko, Shleifer and Vishny, 1996). Virtually all of the Russian economy—raw materials, land, buildings, equipment, and distribution channels—were owned by the state (Nelson and Kuzes, 1994). Title to property was difficult or impossible to establish. Some entrepreneurs acquired these assets simply by stealing them—spontaneous privatization (Blasi, Kroumova and Kruse, 1997). Others had to compete to buy state businesses through auctions (Buss and Yancer, 1996). Still others, who had worked in the black market under communism, instantly became legitimate once entrepreneurship became legal (Plokker, 1990; Jones and Moskoff, 1991). But many simply had to start from scratch. Complicating things were few laws governing business, and those that existed were either contradictory, inappropriate, anti-business or unenforceable. Corrupt bureaucracies, prevalent under communism, remained in place to impede business development. To make matters worse, organized and unorganized crime took over the very fabric of society, making business difficult. Banking systems were non-existent, for the most part, and where banking did exist, they had no interest in lending to small business (Fan, Lee and Schaffer, 1996). Taxes were arbitrary and so high that many businesses could not pay them and also earn a profit. The country had a high inflation rate. Consumers in Russia had little income to purchase goods and services from business. Much business existed through bartering

and accumulation of debt. Overlaying the system was extreme political instability, nationally and regionally.

At this writing, Russia is actually moving backwards as its transition stalls and the economic situation worsens (Buss, in press). Its once large economy now is about the size of Denmark's. Technically, Russia is bankrupt, and is increasingly thought of by many observers as a developing country.

The U.S. Information Agency (USIA), in fall 1993,(1) funded a personal interview survey of 100 entrepreneurs in Nizhny Novgorod to learn about their problems in raising capital and developing businesses in this extreme political/economic environment.(2) The study asked the question, was there a need for microenterprise programs in Russia? Nizhny Novgorod was a natural choice for the study, because at the time, Nizhny was considered the most progressive province in Russia, even more so than Moscow or St. Petersburg. As such, U.S. government agencies--USIA, US Agency for International Development (USAID), Department of Commerce, Peace Corps, and others--poured millions into the region in the form of technical assistance and training, as did the World Bank and International Finance Corporation (IFC)(Buss, 1995). Nizhny was also a good choice, at least symbolically, because it had once been the leading regional commercial city under the czars, so entrepreneurial potential was expected to be high.

In sections below, analysis looks at characteristics of small businesses and entrepreneurs starting them, what problems new firms experienced, how they raised capital and what technical assistance they needed and utilized. Findings are suggestive of the business development needs of microenterprise in transitional economies.

Characteristics of Entrepreneurs and Businesses

The average Nizhny entrepreneur, starting a business in the early stages of transition, was married, 30 years of age, male, white, and living above official poverty levels (see Table 1). Nizhny entrepreneurs reported having only 6.9 years of formal education on average. Most Nizhny entrepreneurs worked full-time at the business they started, apparently preferring not to find jobs in an unstable economy with large moribund firms.

Table 1
Demographic Characteristics.

% work at another job	14.4
average age	36.7
average years of education	6.9
% married	84.5
% below poverty	1.0
% women	20.8
% white	100.0

The average Nizhny small business started up about a year and one-half prior to our interview, in the interval 1991 to 1993, suggesting that entrepreneurs wasted no time in taking advantage of economic reforms in full swing under President Yeltsin (see Table 2).(3) Partnerships or joint ventures dominated business organizational structures in Nizhny. One-third of their partners were foreigners, and nearly every business desired a foreign partner, reflecting the need to import capital, if not expertise,(4) to make their business viable. Most businesses were new, with only 6% having once been subdivisions of state-owned firms. Many state-owned enterprises were simply not worth resurrecting. Nizhny businesses employ relatively large workforces, but this is deceptive. The average business employed 47 workers, about 39 full-time and 11 part-time. At start up, entrepreneurs employed about 51 workers, both full- and part-time. Eighty-eight percent of businesses grew overall during this period, with some expansion and contraction. businesses were not seasonal operations.

These data probably reflect reluctance of entrepreneurs to layoff workers even though this threatened both efficiency and profitability, and low wage demands, making it inexpensive to hire a large workforce. Generally, Russian firms tend to employ many more workers to do a job than do Western firms. A favorite Russian saying at the time was, the West has unemployed workers outside the factory, in Russia workers are unemployed within it. Large numbers of workers labored without wages, hoping their job would eventually allow them to earn a living. Some workers who received no wages might have been paid in bartered goods or in-kind services. Many firms retained family members to work in the business. In transitional economies, then, microenterprises may be somewhat larger than the artificial cutoff

point of 10 workers used by many microcredit programs to establish eligibility for credit.

Table 2
Characteristics of Businesses

% cooperative	12.5
% formerly state-owned	6.4
% partnership or joint venture	88.7
% with foreign partner	34.5
% wanting foreign partner	97.9
average # employees now	108.9
average # full-time employees	96.0
average # part-time employees	19.8
average # employees when started	74.4
% seasonal business	0.0
average months in business	20.9
% family member working at business	33.0

Retail and wholesale trade dominated the Nizhny regional economy (33%). Manufacturing (26%) and services (27%) were also evident. Construction accounted for 9%. Insurance (1%), transportation (1%), and agricultural food processing (2%) constituted the remainder. Retail, wholesale and services, almost three-fifths of new businesses, likely predominated because there was little risk involved in failure. Businesses required little overhead, and goods lost, stolen or unsold were of little value in many cases. And, of course, many risked only their labor. Bankruptcy laws and courts were not yet in place, so entrepreneurs were not likely held accountable for bad debt or breach of contract (Boycko, Shleifer and Vishny, 1996).

Manufacturing also was low risk. Entrepreneurs often worked in state-owned factories using machines and materials to make products they sold on their own, with or without official approval. Others took over failed enterprises with little investment, trying to make them viable. Even workers taking over firms at auction invested privatization vouchers given them by the state.

The construction industry boomed at this time. Government invested heavily in rehabilitating public buildings and infrastructure.

Foreign investors also improved buildings and factories. Russia's nouveau riche built mansions and dachas at an astonishing clip, absorbing a great deal of labor.

Table 3
Why Business Started (%).

lost job	3.1
closed other business	0.0
needed more income	17.5
had a good idea for business	50.5
wanted to work for myself	75.3
no other jobs available	1.0
no choice	4.1
make more money	61.9
fulfill my dream	39.2
to leave something to my heirs	14.4

Surprisingly, businesses in Nizhny started for positive motivations (see Table 3). Entrepreneurs had a good business idea, wanted to work for themselves, or sought to fulfill a dream. Many also wanted to make more money. Few started a business because they had no other employment opportunities or had lost a job and could find no replacement—at least one as desirable as working for themselves. Contrary to what many outside observers might believe, these figures illustrate the prevalence of the entrepreneurial spirit in Russia. Nearly 75 years of communism could not extinguish the flame of self-employment.

Business Problems

Nizhny entrepreneurs experienced problems with the economy, government, and crime to a much greater extent than entrepreneurs in most other world economies (see Table 4). Entrepreneurs railed against the poor inflated economy, high taxes, and high interest rates. They also complained about government paperwork and the ever changing laws affecting business. High rents and costs of supplies, materials, buildings and equipment, at the time of this study mostly controlled by government, were too high. One-in-ten expressed problems with earnings from the business. Most had no problem with customers not

paying bills, although many firms pay one another in kind. This means that although times were bad economically, entrepreneurs found ways to overcome these difficulties. Entrepreneurs did not report much interference by government in their affairs. Very likely, given their other responses, either they were afraid to express these fears, or were successfully operating without government awareness or oversight.

Table 4
Business Problems (%).

raising money	15.5
having money to pay expenses	12.4
high interest rates	69.1
high taxes	91.8
government regulations	49.5
finding qualified workers	35.1
poor sale/earnings	9.3
getting advice or help	24.7
customers not paying bills	28.9
excessive government paperwork	49.5
not enough time to get work done	26.8
cost of land, buildings, equipment	53.6
high rents	55.7
cost of supplies/materials	43.3
not enough customers	13.4
excessive competition	14.4
economy/inflation	88.7
lack of experience	27.8
entered business at wrong time	10.3
cost of heat/electricity	47.4
continuing education	18.6
language skills	60.8
mafia	18.6
government interference	22.7
crime	83.5
changing business laws	96.9
telephone system	78.4

Crime was a major problem. This included street crime and organized crime. Even though crime was reported to be a major

problem, the mafia was only cited as a problem by one-fifth of respondents. Entrepreneurs clearly fear organized crime and were reluctant to talk about it. In some cases, entrepreneurs may have been a partner to it. The telephone system was cited as a problem, but Nizhny was beginning to upgrade it. There appears to be a market for language training among entrepreneurs: 60% felt that they needed better language skills.

About 15% of entrepreneurs reported difficulty in raising capital. These entrepreneurs are likely targets for microcredit programs (see also section below, "Capital").

All of the problems with the economy, government and crime were reported to have worsened for many entrepreneurs, since starting their businesses nearly two years ago (see Table 5). But, Nizhny entrepreneurs seemed eternally optimistic, a characteristic of entrepreneurs in many places (see Table 11, below).

Table 5
Problems at Present and Two Years Ago (%).

Problem:	Now	Two Years Ago	
		Worse	Better
raising money.	15.5	6.3	29.2
having money to pay expenses . . .	12.4	5.2	19.6
high interest rates.	69.1	56.7	33.0
high taxes	91.8	72.2	26.8
government regulations	49.5	46.4	35.1
finding qualified workers.	35.1	4.1	20.6
poor sale/earnings	9.3	5.2	14.4
getting advice or help	24.7	1.0	9.3
customers not paying bills	28.9	13.4	29.9
excessive government paperwork	49.5	30.2	46.9
not enough time to get work done	26.8	5.2	44.3
telephone system	78.4	23.7	4.1
cost of land, buildings, equipment	53.6	46.4	38.1
high rents	55.7	57.7	30.9
cost of supplies/materials	43.3	40.2	32.0
high social security taxes	33.0	27.8	21.6
not enough customers	13.4	5.2	18.6
excessive competition.	14.4	17.5	46.4
economy/inflation.	88.7	61.9	36.1
lack of experience	27.8	1.0	0.0
entered business at wrong time.	10.3	1.0	0.0
cost of heat/electricity	47.4	38.1	19.6
continuing education in trade or profession	18.6	2.1	0.0
language skills.	60.8	2.1	0.0
mafia.	18.6	12.4	38.1
government interference	83.5	39.2	52.6
changing laws governing business.	96.9	92.8	5.8

Entrepreneurs were asked about problems specific to their businesses (see Table 6). The two most-cited problems were interpreting business laws either passed by the Duma, Russia's Parliament, or executed by decree by President Boris Yeltsin, and developing an accounting system, a related problem. These reflect the legal complexities in moving away from a planned to a market economy. Next in importance were creating personnel policies, designing production processes, and structuring a management team.

Table 6
Problems in Business (%).

writing a business plan	20.2
analyzing market/market strategy	47.4
structuring management team	43.3
designing personnel policy	46.4
designing production processes	39.2
developing accounting systems	51.5
developing a financial management system	39.2
structuring financing	40.2
identifying amounts and sources of finance	24.7
preparing a loan package	4.1
interpreting business law	76.0
working with foreign investors	11.3
working with local government	30.9

Most entrepreneurs reported few problems in finding capital and in preparing loan applications, but they did have problems structuring their business finances. By implication, this probably means that entrepreneurs may not have obtained capital from the right sources in the right amount given their business needs. Most also had little difficulty working with foreign investors and local governments.

Many Nizhny entrepreneurs were unlikely targets for the technical assistance side of microenterprise programs (see also section below, "Seeking Assistance").

Table 7
Major Competitors (%).

Major competitors are:	
small businesses	74.2
black market	11.3
state-owned firms	40.2
foreign firms	5.2
within 50 miles	87.5

Nizhny entrepreneur perceptions of their competition were examined next. (Recall above in Table 4 that only 14% reported competition as a problem and that only 13% felt that they did not have enough customers.) In Table 7, major competitors were other small businesses and state-owned firms operating within 50 miles. Black market and foreign competition was not reported as a problem.

Seeking Assistance

Nizhny entrepreneurs did not seek advice or technical assistance from high visibility international organizations—International Finance Corporation, International Executive Services Corps or Peace Corps or other institutions (see Table 8). Rather, they relied on attorneys, accountants and business acquaintances. Universities and government organizations were also not used. International organizations and local universities, at least in these early days, had little expertise in business law and practice in Russia. It was difficult to establish microenterprise programs that could go beyond basic business consultation. So they may offer general advice, but entrepreneurs need help solving technical problems. Another factor may be the need to have professionals (e.g., attorneys and accountants) act as intermediaries between government and banks and perhaps state-owned firms. Russia during this period was dominated by opportunists or “fixers,” who, for compensation, facilitated business development and activity by pulling strings on behalf of entrepreneurs. International assistance organizations had difficulty performing this role, obviously because of ethical and legal restrictions against bribery and influence peddling.

Table 8
Sources of Business Advice (%).

other business people	71.1
universities	6.2
friends and relatives	58.8
attorneys	80.4
accountants	68.0
government agencies	30.9
<u>Have you ever sought help from:</u>	
International Finance Corporation	1.0
Peace Corps	3.0
International Executive Service Corps	2.1
Other foreign programs	2.1

Nizhny entrepreneurs were interested in formal training in business topics (see Table 9). Most preferred courses or workshops, probably because they had little time or money for degree programs. Entrepreneurs also wanted to participate in trade shows and to belong to business associations. One role for international organizations working in the region would be to help facilitate this.

Table 9
Business Interests (%).

Obtaining a business degree	37.1
Taking business courses	43.3
Attending workshops for business	86.6
Attending trade shows	75.3
Joining a business association	81.9

Unlike those in developing countries, Nizhny entrepreneurs had no use for social intermediation common in microenterprise programs (Edgcomb and Barton, 1998). Russia appears in many ways to be a developing country, but it is not with respect to business.

Capital

Access to capital was frequently cited as a major problem in Russia, especially in commercial banking. Entrepreneurs were asked about seeking bank loans: three-fifths applied for a bank loan in the past two years (see Table 10). Of those applying, 78% were successful in obtaining the loan. At least among these entrepreneurs, there appeared not to be as severe a credit crunch as expected. A significant number of entrepreneurs did need credit, but could not acquire it. Russian banks in early years of transition made money by borrowing at favorable terms from the central bank, then benefiting from inflation. Russian banks later on earned money by acquiring state-owned firms in sweetheart deals with government colleagues. To date, Russian banks virtually ignore small business lending.

Table 10
Capital and Business Development.

Have you ever sought a loan? (yes)	56.7
If yes, were you successful in	
obtaining the loan (yes)	78.2
Average start-up cost	25 million
Do you intend to borrow money in	
in next year?(yes)	66.0
If yes, for what purpose?	
working capital	54.4
land	21.6
buildings	30.9
machines, equipment	48.5
vehicles	20.6
other	14.4
How much do you want to borrow?	75 million

On average, entrepreneurs required about 24 million roubles—between \$25,000 to \$50,000—to start their businesses. Some 66% reported that they will try to borrow additional money in the next year (following the survey). The average amount to be borrowed in the future was 75 million roubles—between \$75,000 to \$150,000. Most of this funding was to be used for working capital and to purchase equipment, some for purchase land, buildings and vehicles as well.

Capital requirements, even if exaggerated, did not far exceed most microcredit program limitations which could be as much as \$25,000, and in some cases \$40,000, in developed countries like the United States for firms making a transition from micro-level to full-fledged small businesses. Even so, these figures seem suspect. Perhaps entrepreneurs may have exaggerated to add importance to their venture. Because assets in firms were tied mostly to buildings and equipment that at the time did not have a market value, entrepreneurs may have greatly over-estimated their value. Certainly some entrepreneurs, given the size of their businesses, could have benefited from loans of several thousand dollars in a country where manufacturing workers earned about \$20 to \$30 a month. This paradox remains unresolved.

Prospects For The Future

Nizhny entrepreneurs were optimistic about the future of their businesses (see Table 11). Nearly all intended to expand by adding new products or services, hiring more workers, and expanding operations. Only a handful intended to shutdown or sell out.

Table 11
Prospects for the Future (%).

Get out of business	2.1
Sell business	0.0
Add products or services	89.7
Increase workforce	82.5
Expand operations	88.7
Reorganize company	23.7

Conclusion

This profile of small businesses starting up in Nizhny Novgorod during the initial stages of Russia's political/economic transition from a centrally planned economy to something well short of a market based economy offers a rare view of microenterprise development. A substantial number of new small businesses could have benefited from credit in the thousands of American dollars. Eventually, international assistance organizations provided some credit through their auspices,

but commercial banks have yet to extend credit to small business, let alone microenterprise.

Russian small business does not need social intermediation programs common in developing countries (Edgcomb and Barton, 1998). Entrepreneurial problems relate exclusively to the economy and business.

Technical assistance to business was not widely used or desired by Nizhny entrepreneurs. Nizhny entrepreneurs may not have valued service offered to them. Provider organizations just do not have the expertise to offer anything but rudimentary services. Peace Corps volunteers in Nizhny, for example, were MBAs fresh from American graduate schools. Not only did they lack business experience, but they were ignorant of Russian business law and practice. As such, legal and accounting professionals provide most of the business services to small business. One possible exception might be assistance to help them downsize their bloated workforces. This is difficult in any country, but especially so in cases where workers keep hanging on for want of better alternatives.

Notes

1. The lead author worked in Russia from January 1993 to June 1997 coordinating technical assistance and training programs in economic development in Nizhny Novgorod and several other Russian cities: Yekaterinburg, Chylabinsk, Saratov, and Vladivostok.
2. Researchers used the public registry of companies to develop a list of private firms to be interviewed. This list was supplemented with another list of entrepreneurs developed by visiting businesses throughout the central city. Only firms employing less than 100 workers were included in the study. A personal interview questionnaire widely used in entrepreneurship studies in America was customized for Russia. The questionnaire was piloted on 10 Russian firms. The questionnaire took about one hour to conduct. Although researchers tried to develop a complete list of firms and produce a random sample for analysis, we cannot guarantee that the sample is random. At the time, no one could identify entrepreneurs in business. A Russian national from the Foreign Language Institute completed the interviews in fall 1993.

3. Entrepreneurship for individuals and collectives was legalized in 1986 under the Law on Individual Labor Activity (Plokker, 1990).
4. Many foreign partners report having difficulty sharing responsibility with Russian managers.

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Biographical Sketches