

# Comparison: the Birth of SMEs in Russia and UK

# Hypotheses to Be Tested

- Hypothesis #1: the institutional environment in UK was more appropriate for SMEs sector development than the institutional mindset in Russia in 90s.
- Hypothesis #2: As a result of this, SMEs in UK were in better position than SMEs in Russia in the end of 90s (the end of transition process).
- Hypothesis #3: for Russia, as a transition economy, the rise of the SME sector is more important than for the UK.

# SMEs – Formal Definition: In Russian and in the UK

	SME Segmentation			
	Russia		EU	
	<i>Revenue (eur mln)</i>	<i>Number of employees</i>	<i>Revenue (eur mln)</i>	<i>Number of employees</i>
Medium	10-25	101-250	10-50	50-250
Small	1.5-10	15-100	2-10	10-50
Micro	<1.5	<15	<2	<10

European Investment Bank, 2013

# Institutions – Formal Definition and Explanation

- “we may define institutions as systems of established and prevalent social rules that structure social interactions. Language, money, law, systems of weights and measures, table manners, and firms (and other organizations) are thus all institutions.”

Hodgson, 2006

# Institutions – Formal Definition and Explanation

- Institutional environment involve:
  - Legal system
  - Religion
  - Traditions
  - Customs
  - The way the society and the authorities cooperate with each other and interact with each other
  - The way the members of the society cooperate with each other

# Institutional Environment in Russia: From Communism to the Free Market and the Accomplishing Vulnerability

- “It is also necessary to keep in mind that the delayed establishment of certain political institutions and especially the adoption of constitutions have considerably reduced the chances of democracy being consolidated in some parts of the former Communist Bloc. The failure to reach agreement between members of the democratic opposition and communist elite in certain Eastern European countries has left a whole range of institutional issues unresolved. This is one of the main reasons for the high vulnerability of post-communist structural arrangements and for the uncertain future of reforms in other fields.”

• Andreev, 2003

# Institutional Environment in Russia; What Type of the Institutional Mindset the Post-Communist Economies are Characterized by?

- Lower degree of economic and political freedom (Peev, Mueller, 2014) in comparison to European economies.
- Russian case: the “hybridization” regime: the hybrid of the democratic and the previous regimes of the centralized planned economy (Kubicek, 2015)
- High levels of corruption

“The business environment suffers from inconsistent application of laws and lack of transparency in public administration. The public procurement sector is notoriously corrupt, with fraud related to government tenders costing the state billions of dollars each year.”  
(Business Anti-Corruption Portal)

# Transformation Process in Russia: Conclusion

- The process of the transformation to the free market occurred quickly and dramatically
- As a result, despite the fact SMEs could legally operate on the market, their further development was interrupted by the inappropriate institutions.
- The dynamics presented below reinforces this statement.

Year	1994	1995	1996	1997	1998	1999
Number of firms (thousands)	896	877,3	841,7	861,1	868,0	890,0
Number of full-time employees (thousands)	8,479.9	8,994.8	6,269.1	6,514.8	6,207.8	6,292,3
Number of part-time employees (thousands)	6,676.6	4,926.2	2,352.1	2,124.4	1,193.6	970.2

Kommersant, March 16, 2000, quoted by Polishchuk



# Transformation Process in Russia: Conclusion

- The graph below shows that due to the poor business environment, Russia was well behind the majority of European countries in terms of the SMEs sector performance (the 1998 statistics)

Country	Number of SMEs ( thousands)	Number of SMEs per 1,000 of population	Employment by SMEs (million)	% of total employment	Share of GDP
UK	2,630	46	13.6	49	50-53
Germany	3,920	37	18.5	46	50-52
Italy	3,920	68	16.8	73	57-60
France	1,980	35	15.2	54	55-62
EU	15,770	45	68	72	63-67
USA	19,300	74.2	70.2	54	50-52
Japan	6,450	49.6	39.5	78	52-55
Russia	844	5.7	8.3	13	10-11

Source: Small Business Statistics. (In Russian). Small Business Resource Center, 1998 quoted by Polishchuk

# Institutional Environment in UK; Old Good Anglo-Saxon Liberal Model.

- Well-established model
- Developed in XVII century after Revolution and introducing the Parliamentary
- Citizens are responsible for themselves
- Citizens can choose between public and private services
- The taxes are relatively low in comparison with the majority of European states
- The extent to which government can interrupt in the social life is limited
- (EUROFRAME-EFN, 2007)

# Conclusion: What type of regulation do the SMEs really need?

- Stability
- No pressure from the side of government
- Low taxation
- The easy procedure of running and establishment
- Low administrative barriers
- Stable economic environment
- Stable political environment

# Conclusion

- Institutions in UK were much more appropriate for running business than institutions in Russia
  - Well-established business environment as well as the liberal economic principles are better for SME sector functioning
  - In Russia, sudden liberalization led to the sudden increase in the number of SMEs; however, as the environment was not appropriate, the sector went to stagnation
  - As a result, in the end of 90s, all the SME indicators of UK were better than those of Russia.
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- Hypothesis 1: confirmed
  - Hypothesis 2: confirmed

# Transition Economies: Definition

- “The term ‘transition’ usually refers to the process of institutional and structural change, such as those that took place in post-communist Eastern Europe from the early 1990s.”

(Rohac, 2006)

# Russian Transition Economy: Main Problems Concerning Doing Business

- Low levels of the economic and political freedom
- Low innovation capacity
- Ineffective Markets

• IMF, 2008

# SMEs: the Consequences of Establishing the Competitive SMEs Sector.

- “evidence suggests that sustained economic growth depends on a subtle interplay between SMEs and large firms, with SMEs playing a major role in job creation. Similarly, sustained growth in transition and developing economies also depends on a strong contribution by SMEs – the experience of Chinese Taipei being the classic case. In many T&DEs, however, economic conditions and the policy environment have stifled SME dynamism. While there may be many SMEs, they are often undercapitalised and technologically weak, operating outside the formal sector of the economy.”

• OECD, 2000

# SMEs: the Consequences of Establishing the Competitive SMEs Sector.

- SME sector adjusts quickly for the new market conditions, thus providing the market with liquidity and improving its efficiency
- SME sector can promote innovation; big firms benefit from the economies of scale, while SMEs can promote their competitiveness via the high productivity (Wolanski, 2013)
- In a country, where a lot of individuals are engaged in the entrepreneurial activity, their awareness of the economic rights and freedoms improves. This results in the higher levels of economic freedom



# Conclusion: SMEs Sector Can Push the Economy to the Liberalization

- Therefore, the development of the SME sector can resolve some of the basic problems the business environment in Russia is characterized by
- Hypothesis 3: confirmed

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