

**SUSTAINABLE ENTREPRENEURSHIP
REGIONAL AND COUNTRY STUDIES**

Eastern Europe

SUSTAINABLE ENTREPRENEURSHIP PROJECT

Dr. Alan S. Gutterman

Sustainable Entrepreneurship: Regional and Country Studies (Eastern Europe)

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The Sustainable Entrepreneurship Project (www.seproject.org) engages in and promotes research, education and training activities relating to entrepreneurial ventures launched with the aspiration to create sustainable enterprises that achieve significant growth in scale and value creation through the development of innovative products or services which form the basis for a successful international business. In furtherance of its mission the Project is involved in the preparation and distribution of Libraries of Resources for Sustainable Entrepreneurs covering Entrepreneurship, Leadership, Management, Organizational Design, Organizational Culture, Strategic Planning, Governance, Corporate Social Responsibility, Compliance and Risk Management, Finance, Human Resources, Product Development and Commercialization, Technology Management, Globalization, and Managing Growth and Change.

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PART VI

EASTERN EUROPE

Preface

Researchers working on the Global Leadership and Organizational Behavior Effectiveness project, commonly referred to as “GLOBE” project¹, concluded that the respondents to their surveys could be classified into 62 “societal cultures”. In order to facilitate meaningful interpretation of the results the researchers determined that the societal cultures they were investigating could be meaningfully placed into one of ten “societal clusters,” sometimes simply referred to as clusters. The clusters were designed, defined and created before the research was conducted, not as a result of the findings reached once the data was collected and analyzed, and were based on a variety of factors including the results of previous empirical studies; other factors such as common language, geography and religion; and historical accounts.² Societal cultures in the Eastern Europe cluster include Albania, Georgia, Greece, Hungary, Kazakhstan, Poland, Russia and Slovenia.³ Societies in the Eastern Europe cluster were high on assertiveness, in-group collectivism and gender egalitarianism and low on performance orientation, future orientation and uncertainty avoidance. As a result, these societies tended to value forcefulness, support for other members of in-groups and gender equality while deemphasizing the drive for achievement, the use of rules and laws to maintain order and reliance on strategic planning to reduce uncertainty.⁴

The degree of similarity or dissimilarity between the Eastern Europe cluster and the other nine societal clusters with respect to the cultural dimensions measured during the GLOBE study was as follows⁵:

¹ For detailed discussion of the GLOBE project, see “Globalization: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).

² For extensive discussion of the design of the societal cultures and the reasons for placement of societies within those clusters see Chapter 10 of R. House, P. Hanges, M. Javidan, P. Dorfman and V. Gupta (Eds), *Culture, Leadership, and Organizations: The GLOBE Study of 62 Societies* (Thousand Oaks CA: Sage, 2004), 536. See also V. Gupta, P. Hanges and P. Dorfman, “Culture clusters: Methodology and findings,” *Journal of World Business*, 37(1) (2002), 11-15.

³ For further information on this cluster, see G. Bakacsi, S. Takacs, A. Karacsonyi, and V. Imrek, “Eastern European cluster: Tradition and transition,” *Journal of World Business*, 37(1) (2002), 69-80.

⁴ P. Northouse, *Leadership: Theory and Practice* (4th Ed) (Thousand Oaks, CA: Sage, 2006), 310.

⁵ Chapter 10 of R. House, P. Hanges, M. Javidan, P. Dorfman and V. Gupta (Eds), *Culture, Leadership, and Organizations: The GLOBE Study of 62 Societies* (Thousand Oaks CA: Sage, 2004). The descriptors of the degree of correlation were provided by the author of this publication and are not based on statistical measures of correlation but are provided only to assist readers in understanding that there are definite patterns in the identified differences between the societal clusters with respect to cultural dimensions. It should also be noted that simply because two societal clusters are grouped together on the table does not mean that they are strongly similar in their cultural profile and, in fact, societal clusters which are grouped as “neutral” are generally quite dissimilar to one another although roughly the same degree of difference from the cluster to which they are being compared in the table.

Correlation	Societal Clusters
Strong Similarity	Middle East (Arab); Sub-Saharan Africa
Mild Similarity	Confucian Asia; Latin Europe
Neutral	Southern Asia; Germanic Europe
Mild Dissimilarity	Latin America; Anglo
Strong Dissimilarity	Nordic Europe

Based on the information in the table above a manager from a society in the Eastern Europe cluster would expect to find familiar cultural values, although not precisely the same as in his or her own society, in the Middle East (Arab) and Sub-Saharan Africa clusters but would need to be especially careful and mindful of significant cultural differences in the Nordic European cluster.

The following chart depicts the relative importance and intensity of endorsement of the six culturally endorsed leadership dimensions to the societies included in the Eastern Europe cluster:

Level of Importance/Endorsement	Leadership Dimension
High	Autonomous Leadership
High	Self Protective Leadership
Moderate	Charismatic/Value-Based Leadership
Moderate	Team Oriented Leadership
Moderate	Humane Oriented Leadership
Low	Participative Leadership

Of the ten societal clusters the Eastern Europe cluster most strongly associated autonomous leadership with effective leadership with a mean score within the cluster (4.20) that was slightly above the mid-point of 4 on the 1-to-7 measurement scale. Leaders in societies in the Eastern Europe cluster are most likely to be perceived as effective if they practice independent, individualistic and self-centric leadership and focus on ensuring the safety and security of the group or group members. Preferred leadership behaviors among these societies include being status- and class-conscious, ritualistic, procedural, normative, secretive, evasive, indirect, self-centered and asocial. Societies in the Eastern Europe cluster do not expect their leaders to involve others in making and implementing decisions. The leadership profile of the Eastern Europe cluster is moderately similar to the profile for the Middle East cluster and strongly different than the profiles of the Sub-Saharan Africa, Nordic Europe and Anglo clusters. Leaders from the US and other societies in the Anglo cluster can expect substantial difficulties in deploying their preferred leadership styles in the Eastern Europe cluster.

Russia and other countries that were formerly part of the Soviet Union were not included in the initial studies conducted by Hofstede and others during the 1980s and 1990s due to the difficulties associated with gaining access to data regarding managers and

subordinates in those countries.⁶ Hofstede himself hypothesized that the likely cultural profile for Russian managers would be high power distance, high uncertainty avoidance, medium-range individualism and low masculinity.⁷ Other researchers subsequently conducted actual tests of Russian managers, sometimes as part of comparative studies with other countries such as the US, and confirmed these hypotheses.⁸ In recent years there has been increasing interest in studying countries in the Eastern Europe cluster. For example, Brodbeck et al. found that the leadership dimension they referred to as interpersonal directness and proximity, which they explained was generally the opposite of GLOBE's self protective leadership, dimension were less prevalent in South/East European countries, including countries in the Eastern Europe cluster, than in North/West European countries.⁹ This finding supporting the conclusion reached by the GLOBE researchers that indirectness was perceived to be prototypical of outstanding leadership in the Eastern Europe cluster while at the same time being disapproved in the Nordic Europe cluster.¹⁰ Brodbeck et al. also found that participative leadership, which was strongly endorsed as an effective leadership style in France and in countries in the

⁶ A comprehensive review of initial studies on country clustering was prepared and published by S. Ronen and O. Shenkar, "Clustering countries on attitudinal dimensions: A review and synthesis", *Academy of Management Review*, 10 (1985), 435-454. For further discussion of the various research studies reviewed by Ronen and Shenkar, see "Globalization: A Library of Resources for Sustainable Entrepreneurs" prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org). Ronen and Shenkar noted that use of a statistical procedure known as "smallest space analysis" led them to include Yugoslavia in their "Near Eastern" cluster along with Greece, Iran and Turkey.

⁷ A. Ardichvili and K. Kuchinke, "Leadership styles and cultural values among managers and subordinates: a comparative study of four countries of the former Soviet Union, Germany and the US," *Human Resource Development International*, 5(1) (2002): 99-117, 101 (citing G. Hofstede, "Cultural constraints in management theories", *The Academy of Management Executive*, 7(1) (1993), 81-94).

⁸ See, e.g., A. Naumov, "Hofstede's measurement of Russia: the influence of national culture on business management," *Management*, 1(3) (1996): 70-103; and D. Elenkov, "Can American management concepts work in Russia? A cross-cultural comparative study," *California Management Review*, 40(4) (1998): 133-156 (finding higher individualism among US managers in comparison to Russian managers and lower power distance and uncertainty avoidance among US managers in comparison to Russian managers).

⁹ F. Brodbeck, M. Frese, S. Akerblom, G. Audia, G. Bakacsi, H. Bendova, et al., "Cultural variation of leadership prototypes across 22 European countries," *Journal of Occupational and Organizational Psychology*, 73(1) (2000), 1-29. While Brodbeck et al. borrowed significantly from the GLOBE project they chose to design and analyze three of their own leadership dimensions: interpersonal directness and proximity, autonomy and modesty. The first dimension, interpersonal directness and proximity, was closely associated, albeit negatively, with several of the key attributes associated with self protective leadership. Specifically, the researchers explained that interpersonal directness and proximity "... was shown to be most distinctively and negatively associated with Face Saver, comprising leadership attributes such as indirect, evasive, avoids negatives and face saving; with Self Centered, comprising the attributes, self interested, non-participative, loner and asocial; and with Administrative, comprising orderly organized and good administrator." The researchers also noted that interpersonal directness and proximity "... was most distinctly and positively related with Inspirational, comprising for example enthusiastic, encouraging, confidence builder, morale booster and motive arouser; and with Integrity comprising for example, honest, sincere, just and trustworthy." In summary, the label "directness" was the opposite of "face saving" (i.e., self protective in the language of the GLOBE leadership dimensions). It should be noted that Brodbeck et al. found that their interpersonal directness and proximity dimension mainly separated the South/East European countries from the North/West European countries (i.e., Germanic, Anglo and Nordic European countries).

¹⁰ Id. As noted above, the leadership profiles of the Eastern Europe and Nordic Europe clusters are strongly different from one another.

North/West European region, received a lukewarm reception among countries in the South/East European region, including countries in the Eastern Europe cluster.¹¹

Other researchers have found that, compared to Germany and the US, four former countries of the Soviet Union (Georgia, Kazakhstan, Kyrgyzstan and Russia) differed primarily by a much lower level of power distance, higher levels of masculinity, and much longer planning horizons.¹² They also found important differences among the four countries with respect to both cultural values and their attitudes regarding the use and effectiveness of transformational leadership styles, an indication that the diverse historical backgrounds of those countries undermined the notion that they should somehow be viewed as a homogenous group simply because they shared Soviet domination. The researchers also commented that their findings caused them to question the validity and utility of grouping countries into clusters based on geographic proximity, religion and language.¹³

References and Resources

Additional information on studies and commentaries relating to various aspects of leadership and management styles and practices in Eastern Europe can be found in the Sustainable Entrepreneur's Libraries of Resources prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org) covering Leadership, Management, Organizational Design, Organizational Culture, Strategic Planning, Governance, Corporate Social Responsibility, Finance, Human Resources, Product Development, Technology Management, Globalization and Managing Growth and Change.

§1:1 Introduction

While Russia has been hobbled by economic sanctions imposed by the US and other major countries and continues its history of tumultuous internal political and social struggles, it nonetheless remains one of the world's most promising markets with over 140 million consumers, a growing middle class, and almost unlimited infrastructure needs.¹⁴ As of 2012, Russia was the world's 11th largest economy by nominal gross

¹¹ F. Brodbeck, M. Frese, S. Akerblom, G. Audia, G. Bakacsi, H. Bendova, et al., "Cultural variation of leadership prototypes across 22 European countries," *Journal of Occupational and Organizational Psychology*, 73(1) (2000), 1-29.

¹² A. Ardichvili, "Leadership styles and work-related values of managers and employees of manufacturing enterprises in post-communist countries," *Human Resource Development Quarterly*, 12(4) (2001), 363-383. With respect to the cultural values the differences were generally explained by Hofstede's dimension of masculinity and by paternalism. See also A. Ardichvili, R. Cardozo and A. Gasparishvili, "Leadership styles and management practices of Russian entrepreneurs: implications for transferability of Westerns HRD interventions," *Human Resource Development Quarterly*, 9(2) (1998): 145-155; and A. Ardichvili and K. Kuchinke, "Leadership styles and cultural values among managers and subordinates: a comparative study of four countries of the former Soviet Union, Germany and the US," *Human Resource Development International*, 5(1) (2002): 99-117.

¹³ A. Ardichvili and K. Kuchinke, "Leadership styles and cultural values among managers and subordinates: a comparative study of four countries of the former Soviet Union, Germany and the US," *Human Resource Development International*, 5(1) (2002): 99-117, 112-114.

¹⁴ Russia, Country Commercial Guides, US Commercial Service, http://www.buyusainfo.net/docs/x_2871072.pdf [Accessed April 3, 2013].

domestic product (GDP), 7th largest by purchasing power parity (PPP) and had the highest per capita GDP (US\$17,700) of the BRIC (Brazil, Russia, India and China) countries. Russia has been described as an upper middle income country and offers a highly educated workforce to domestic entrepreneurs and foreign investors. Russia is the largest country in the world. While it has been decades since the Soviet Union collapsed, the Communist party remains the dominant political force and President Vladimir Putin, as president, head of the armed forces and the Security Council, dominates the policies and actions of the central government.

The breakup of the Soviet Union marked a rejection of the centralized state planning system and the beginning of attempts to incorporate free market principles into Russian economic life. The government announced ambitious plans to restructure key national industries through privatization; however, by the mid-1990s it was clear that corruption would undermine these initiatives as the country's most valuable economic resources fell under the control of a well-connected elite rather than being widely redistributed. Moreover, the government retained control over large and important sectors of the economy including assets used in energy, transportation, communications and heavy industry. Interestingly, there was little popular sentiment opposing retention of control by the government with polls taken in the mid-2000s showing that less than 20% of the adult population felt strongly that the country needed to move to freer markets.¹⁵

According to the US Commercial Service, in alphabetical order, the leading business opportunities in Russia as of 2012 were agricultural equipment; apparel; automotive parts and service equipment/accessories; aviation; chemicals/plastics; construction; consumer electronics; electric power generation and transmission equipment; energy efficiency/green build; medical equipment; refinery equipment; safety and security equipment; and travel and tourism to the US. At the same time, however, the US Commercial Service noted that Russia was challenged by seriously underdeveloped infrastructure, an incomplete transition from central planning, burdensome regulatory regimes, inadequate intellectual property rights protection and enforcement, extensive corruption and inadequate rule of law, inconsistent application of laws and regulations, lack of transparency, and the continued presence of large state-owned or controlled enterprises in strategic sectors of the economy.¹⁶

Bollinger analyzed Russian societal culture using the dimensions developed by Hofstede and found that Russia scored high on power distance, a characteristic that led to significant use and acceptance of autocratic and paternalistic leadership and management styles¹⁷; high on uncertainty avoidance, which explained the need among Russian organizations for strict hierarchies and detailed planning and programming of activities; high on collectivism as opposed to individualism, which was demonstrated by the

¹⁵ Id.

¹⁶ Id.

¹⁷ See also Russian Management Style, World Business Culture, <http://www.worldbusinessculture.com/russian-management-style.html> [Accessed February 4, 2013] (management tends to be centralized and directive, with senior executives issuing direct instructions that subordinates are expected to follow; middle managers have little input into strategic decisions; and delegation is limited to giving and following precise instructions).

widespread expectations of employees that their firms would take care of them in the same way as a family in exchange for loyalty from employees; and relatively low on masculinity.¹⁸ While Russia does not have a rigid class structure, there are clearly widening gaps between groups of Russians based on wealth and privilege and, as noted above, a small cadre of businesspeople have come to enjoy substantial economic and political strength through their successes in the new Russian form of capitalism. The breakdown of the Soviet system brought an end to guaranteed full employment and has caused substantial disruption for average workers and their families. While attempts have been made to improve the country's social security system, progress has frequently been slowed and corruption has reduced the efficiency of the system and the availability of benefits.

In 2014 Russia ranked just 18th on the list of the world's most innovative countries developed by Bloomberg, putting it ahead of China but behind a large number of the country's major global competitors and several smaller economies such as the Netherlands and Norway.¹⁹ A 2011 report by the Organisation for Economic Co-operation and Development ("OECD") noted that Russia has been attempting to transition into self-sustaining, innovation-led growth, and that the government had been increasingly focused on modernization and, in particular, on innovation, as the key to Russia's successful development over the longer term.²⁰ The OECD acknowledged that Russia's innovation system had formidable strengths, particularly a high level of education and long-standing excellence in several fields of science and technology; however, the OECD cautioned that innovation would be hindered by a variety of factors such as low levels of research and development and innovation activities in companies, an inadequate infrastructure and "weak framework conditions for innovation (particularly weak competition and regulatory frameworks, corruption and lack of trust)".²¹

According to Bain, Viktor Sedov, the executive director of the US-Russia Centre for Entrepreneurship, felt that "[a] Russian entrepreneur may very well be the most resilient and optimistic entrepreneur in the world".²² Bain noted that entrepreneurship, be it in Russia or anywhere else in the world, was an inherently risky undertaking and argued that the risks were particularly dramatic in Russia during the 1990s when the country was undergoing a continuous stream of economic, political and social crises that necessary created a harsh and uncertain environment for conducting business. What has been referred to as "necessity-based" entrepreneurship was certainly apparent in the years following the breakup of the Soviet Union as citizens toiling in jobs in the state sector found that their positions and services were no longer needed in a country shifting to a

¹⁸ D. Bollinger, "The Four Cornerstones and Three Pillars in the 'House of Russia' Management System", *Journal of Management Development*, 13(2) (1994), 49.

¹⁹ B. Glick, Russia's investment in tech startups depends on overcoming concerns of its new web-savvy generation, *Computer Week* (June 5, 2014), <http://www.computerweekly.com/blogs/editors-blog/2014/06/russias-investment-in-tech-sta.html> (accessed June 27, 2014).

²⁰ OECD Reviews of Innovation Policy: Russian Federation 2011, Directorate for Science, Technology and Industry, 2011, www.oecd.org/sti [Accessed February 4, 2013].

²¹ *Id.*

²² C. Bain, *Entrepreneurship in Russia: Patterns and Problems of its Development in the Post-Soviet Period*, Ph. D Dissertation for University of Glasgow (July 2007), 93.

market-based economy. Bain reported that “social safety net of full employment” that had been in place in the Soviet Union quickly fell apart under the post-Soviet system and that many people found themselves unemployed or underemployed and searching new ways to generate income for the first time in their lives. Bain went on to comment that these conditions would appear to have been optimal for making entrepreneurship a logical alternative for many people, particularly since private sector employment in general had begun offering higher salaries than working for the government; however, Bain reminded that the transition to entrepreneurship, or at the very least being more responsible for finding one’s own job with an employer, could be quite difficult and challenging for many people as the cost of living escalated and pressured increase to find ways to support themselves and their family members.

In their survey of academic literature relating to entrepreneurship in Russia Ojala and Isomäki found that the articles focusing on perceptions of entrepreneurship had reported that there was a more enterprising culture among younger Russians.²³ Unfortunately, Dorell, analyzing the impact of Russian’s invasion of Crimea on the development of the Russian entrepreneurial ecosystems and the plans of the founders of Russian startups who had aspirations for building global businesses, reported that many small Russian companies, as well as a number of larger and more established firms, were pulling out or reducing their presence in Russia on that the basis that it had become too risky to execute a strategy for global growth from Russia given geopolitical conditions that included significant economic sanctions against Russia by Western countries and the announced intent of the Russian government to respond by withdrawing the country from global markets through the adoption of “import substitution” strategies.²⁴ According to Dorell, Russian entrepreneurs operating technology-based startups have realized that they need to move their companies to more secure and freer environments, such as Silicon Valley, Berlin or Tel Aviv, in order to have any realistic hope of securing additional financing from Western investors. The mobility of these companies is enabled by the fact that many of their employees are young, single and highly educated, often with degrees obtained in the West, and are eager and ready to escape a country where recently won freedoms are eroding—new government regulations have imposed substantial restrictions on e-commerce and electronic funds transfers—and an economy that will certainly be less connected to the global economy for years to come.

§1:2 Research on Russian entrepreneurship

Vershinina observed that literature on Russian entrepreneurship was scarce and that much of the research had focused on either on defining the characteristics of Russian entrepreneurs and comparing them to their counterparts in Western countries and/or on the ethical dimensions of operating a small business within the specific local Russian

²³ A. Ojala and H. Isomäki, “Entrepreneurship and small businesses in Russia: A review of empirical research”, *Journal of Small Business and Enterprise Development*, 18(1) (2011), 97.

²⁴ O. Dorell, *Russian Tech Start-Ups Abandon Moscow*, USA Today (May 24, 2014), <http://www.usatoday.com/story/money/business/2014/05/24/russian-start-ups-leave-moscow/9370809/> (accessed June 26, 2014).

context.²⁵ Ojala and Isomäki conducted an extensive review of 48 empirical articles published between 1993 and 2009 that focused on entrepreneurship and small businesses in Russia.²⁶ They reported that the main interests of the articles were the impact of institutional issues on entrepreneurship in Russia, strategic issues related to firms operating in a transitional market, psychological characteristics of Russian entrepreneurs and networks and social capital. The articles relating to institutional issues tended to focus on the effect of governmental regulations on entrepreneurship and small businesses, informal entrepreneurship, and the impact of entrepreneurial activity on economic growth in Russia. Ojala and Isomäki noted that while the articles had documented positive changes in Russia institutional environment for entrepreneurship, the environment remained unstable and entrepreneurial activities were still inhibited by inconsistent regulations and the absence of business laws. As for the strategic issues impacting entrepreneurs and small businesses, the articles reviewed by Ojala and Isomäki concluded that intellectual capital, including human and structural capital, was the major determinant of the performance of small and innovative firms in Russia and that the most common strategic problems for Russian entrepreneurs included the Russian government, difficulties with suppliers, financial problems, high interest rates, finding a good location, production constraints, and internationalization. The articles on the psychological characteristics of Russian entrepreneurs typically attempted to identify and explain differences between them and entrepreneurs from other countries or differences between entrepreneurs and non-entrepreneurs in Russia. Finally, the articles relating to the social capital and networks of Russian entrepreneurs revealed that social networks were an important influence on entrepreneurial opportunities in Russia because persons whose relatives or friends were entrepreneurs had a greater chance of becoming entrepreneurs and that Russian entrepreneurs were satisfied with their existing networks and thus were not inclined to invest time and effort in developing new relationships as long as they were able to find the resources they needed within their existing networks.

§1:3 Entrepreneurship in the post-Soviet period

The number of entrepreneurs and small businesses rose rapidly in Russia during the early 1990s after the fall of the Soviet Union and the beginning of the transition towards a market economy.²⁷ Economic reforms, including privatization, opened up a number of opportunities for entrepreneurs, particularly in the areas of retail trade and services; however, entrepreneurship during these early days of the post-Soviet period faced a number of significant challenges and obstacles including a shortage of qualified managers, since managers and supervisors who worked under the communist system generally just did what they were told and were never required to develop basic strategic

²⁵ N. Vershinina, *Flying Business Class: A Case of Russian Entrepreneurs in London*, Conference Paper for 35th ISBE Conference, Dublin (November 2012) (citing R. Hisrich and M. Grachev, “The Russian entrepreneur: characteristics and prescriptions for success”, *Journal of Managerial Psychology*, 10(2) (1995), 3; and R. Hisrich and M. Grachev, “Ethical dimension of Russian and American entrepreneurs”, *Journal of Small Business and Enterprise Development*, 8(1) (2001), 5).

²⁶ A. Ojala and H. Isomäki, “Entrepreneurship and small businesses in Russia: A review of empirical research”, *Journal of Small Business and Enterprise Development*, 18(1) (2011), 97.

²⁷ Entrepreneurship in Russia, *International Entrepreneurship*, <http://www.internationalentrepreneurship.com/europe/russia/> (accessed February 6, 2013).

and management skills; an inefficient, and often corrupt, bureaucracy that made it difficult, time-consuming and costly for entrepreneurs to secure required official permissions, certifications and registrations; high tax burdens due to discretionary regional and local charges on top of the federal corporate and individual taxes; and the need to contend with criminal organizations that demanded money from new businesses for protection and often controlled key inputs that those businesses needed in order to operate and expand.

Bain provided an overview of the role of the state and the development of entrepreneurship in Russia during the post-Soviet period and noted that efforts to introduce and develop private enterprise in the country beginning in the early 1990s was one of the most fundamental changes to Russian society and ultimately led to the emergence of entrepreneurs as a new social group, one that had long been missing throughout the decades of centralized state control of the economy.²⁸ Bain noted that radical economic reforms were implemented beginning in 1992 with the goal of creating an effective and robust market economy and identified the main elements of those reforms as including price liberalization, privatization and macroeconomic stabilization. The wave of privatization was particularly important for the development of a small- and medium-sized enterprise (“SME”) sector in Russia as it involved larger transfers for property from the state to private citizens; however, Bain pointed out that the privatization initiatives were focused more on changing record title to existing assets and businesses as opposed to creating new businesses and that the state retained de facto control over substantial amounts of property by transferring state-owned assets to companies controlled by directors and shareholders with close ties to the country’s political leadership.

State policies relating to the development of the SME sector during the mid-1990s also included various legal decrees relating to the state support of Russian entrepreneurs and their small businesses including efforts by the state to form an infrastructure to support and develop small businesses; creation of favorable conditions for the use of state financial, material, technical and informational resources; the establishment of simplified procedures for the registration of small businesses, the licensing of their activity, the certification of their products and the submission of accounting reports; and support for the foreign economic activities of small business.²⁹ The government also formed a state committee dedicated to the support and development of small entrepreneurship in Russia and charged that committee with developing proposals to eliminate legal, administrative and economic barriers for SMEs; assessing the effectiveness of state measures; creating an infrastructure of support for SMEs including consulting, information and financial support; overseeing various measures to modernize the equipment and technology of SMEs; supporting promotion of the professional development of cadres in entrepreneurship; and preparing proposals relating to the establishment of tax and other general privileges for SMEs. In addition, a federal fund for support of Russian small businesses was created. Bain noted that Russian government programs relating to

²⁸ C. Bain, *Entrepreneurship in Russia: Patterns and Problems of its Development in the Post-Soviet Period*, Ph. D Dissertation for University of Glasgow (July 2007).

²⁹ *Id.*

development and support of the country's SME sector were accompanied by a various contributions of technical assistance from the international community including assistance from Technical Assistance for the Commonwealth of Independent States, the European Bank for Reconstruction and Development and the United States Agency for International Development.

Bain observed that development of SMEs remained a priority during the 2000s in Russia for a variety of reasons including the need to establish greater balance within the overall Russian economy, which many believed was too dependent on oil and other natural resources; the opportunity to reduce the attention on, and influence of, big business in Russia and create the appearance that steps were being taken to address charges that cronyism played too big a role in Russia's economic policies; and the realization that development of SMEs would be crucial for the Putin government that came to power in the early 2000s to deliver on its promises of doubling the country's GDP in ten years.³⁰ Bain noted, however, that while the official position of the government regarding development of SMEs remained consistent throughout this period, it was far from clear if that position was accompanied by effective policies and support from the state.

Estrin et al, using data collected during the Global Entrepreneurship Monitor ("GEM") project in 2001 and 2002, found strong evidence to support their belief that the relatively low levels of entrepreneurship development in Russia could be attributed to the country's institutional environment and that the environment itself contributed to a relative advantage of entrepreneurial insiders (i.e., persons already in business) over entrepreneurial outsiders (i.e., newcomers not yet involved in operating a business) in terms of the ease of launching a new business.³¹ Specifically, the researchers were able to identify statistically significant support for the hypothesis that the weak institutional framework in Russia, particularly high levels of corruption and the weak rule of law, would cause the level of entrepreneurial entry levels in Russia to be lower than in countries with a stronger institutional framework. Estrin et al. also found support for the proposition that the field of play for Russian entrepreneurs was definitely tilted in favor of existing entrepreneurs with strong personal and governmental ties and that newcomers lacking these ties suffered from the fact that there was no strong institutional environment that they could tap into as an alternative mechanism to assessing the resources (i.e., information, capital and labor) that they needed to launch their new businesses. Aidis et al. argued that the level of entrepreneurial activity in Russia was significantly lower than in other countries that had been making the transition from communism to capitalism and noted that start-up activities in Russia were largely confined to a few individuals who tended to be older, male and educated and that existing entrepreneurs with strong ties to the state had greater opportunities than prospective newcomers to the start-up scene.³²

³⁰ Id.

³¹ S. Estrin, R. Aidis and T. Mickiewicz, *Institutions and Entrepreneurship Development in Russia: A Comparative Perspective*, William Davidson Institute Working Paper Number 867 (February 2007).

³² R. Aidis, S. Estrin and T. Mickiewicz, "Institutions and entrepreneurship development in Russia: A comparative perspective", *Journal of Business Venturing*, 23 (2008), 656, 657.

Bain found that while there had been a significant amount of official support for the country's SME sector the reality was that Russian entrepreneurs were continuously challenged by legislative and tax obstacles, difficulties in accessing credit and administrative barriers.³³ Bain summed up the experience of Russian entrepreneurs during the post-Soviet period as being "caught up in a perpetual cycle of navigating barriers" including accessing credit, finding premises, dealing with the heavy tax burden imposed on businesses in Russia and negotiating through and around a continuously change set of administrative barriers.³⁴ Bain noted this situation caused Russian entrepreneurs to spend a significant amount of time on overcoming obstacles through their personal social networks rather than focusing on operating their businesses in the normal way and led to the creation of a negative public image of entrepreneurship and vulnerability to predatory activities of government officials and criminal racket groups. Bain argued that it was imperative that steps be taken to improve the relationship between Russian entrepreneurs and state officials including more discussions in roundtables and workshops to facilitate mutual understanding of their respective roles in the development of the country's entrepreneurial ecosystem. Bain also pushed for improvement of mechanisms for providing entrepreneurs with access to capital including more loan programs with more flexible terms and reasonable interest rates.

In the country report on Russian entrepreneurship issued by the GEM project in 2011 ("GEM Russia 2011"), Russia was classified as one of the efficiency-driven economies, along with other rapidly developing countries such as Brazil, China and Turkey, meaning that the GEM researchers believed that Russia was in the midst of focusing on implementing efficient production methods to improve productivity and enhancing competitiveness through higher education, market efficiency and improving the capacity to benefit from existing technologies.³⁵ According to GEM Russia 2011, 92.8% of Russia's adult population had no relationship to entrepreneurship and did not consider opening a new business as a means for developing their careers.³⁶ Two-thirds of these "non-entrepreneurs" believed they did not have sufficient knowledge and experience to engage in entrepreneurial activities and 81% of them were pessimistic about conditions for starting a new business in Russia at that time. GEM Russia 2011 reported that the level of entrepreneurial intentions in Russia, measured by the number of adults with plans to open a business within the next three years, was among the lowest in the GEM countries at that time. For a majority of the Russian entrepreneurs, opening up a new business was considered to be a voluntary act; however, the primary motivation for most of them was to achieve support income as opposed to increasing their current income or gain more autonomy.

62.9% of the Russian early-stage entrepreneurial companies identified in GEM Russia 2011 employed from one to five people, 7.7% of the companies were classified as self-

³³ C. Bain, *Entrepreneurship in Russia: Patterns and Problems of its Development in the Post-Soviet Period*, Ph. D Dissertation for University of Glasgow (July 2007).

³⁴ *Id.* at 156 and 218.

³⁵ O. Verkhovskaia and M. Dorokhina (Eds.), *Global Entrepreneurship Monitor: Russia 2011*, Global Entrepreneurship Monitor (2011).

³⁶ *Id.*

employed and about 6% of the companies employed 20 or more people.³⁷ GEM Russia 2011 noted that 19.2% of the early-stage entrepreneurs and 24.3% of the established entrepreneurs had plans to create 20 or more jobs over the next five years; however, the researchers cautioned that the early-stage entrepreneurs might have been too optimistic in establishing their projections. Male entrepreneurs, and entrepreneurs with higher levels of education, were more likely to have aspirations for high growth and companies engaged in rendering business services were the most likely to be on a projected path for expansion over the five year period following completion of the survey.

GEM Russia 2011 reported that both early-stage and established entrepreneurs in Russia were typically involved in producing good that were already on the market (i.e., not new to consumers when introduced) and while early-stage entrepreneurs said that they were optimistic about the possibility of developing novel goods and services in the future the researchers cautioned that members of this group may not have sufficient experience and knowledge of the market to make a realistic and objective evaluation of novelty.³⁸ Similar results were obtained when entrepreneurs were asked about current and projected use of new technologies in their business activities. Substantial majorities of both early-stage and established entrepreneurs in Russia perceived the environments in which they operated as highly competitive and the researchers noted that this finding might well be attributed to the fact that most of those entrepreneurs were operating in the consumer sector and offering standard lines of products and services.

GEM Russia 2011 included an assessment of the country's entrepreneurial framework conditions by a group of experts.³⁹ Of all of the factors considered, only four of them were found to be exerting a favorable influence on the entrepreneurial climate in Russia: market dynamics, the state of the physical infrastructure, professional education and commercial infrastructure. The remaining factors were considered to be impediments to the opening of new companies and developing of existing businesses, with the lowest scores assigned to bureaucracy, the level of development of R&D transfer, barriers to market entry, availability of financial resources and support for new and developing firms, primary and secondary education and state programs providing direct support for entrepreneurship. The experts also criticized the day-to-day execution of governmental policies with respect to entrepreneurship, noting that entrepreneurs regularly faced lengthy periods of review and delay before final actions were taken on their efforts to obtain licenses and permits required to launch their businesses.

The experts surveyed as part of GEM Russia 2011 felt that Russia lacked a clearly expressed favorable orientation toward entrepreneurship in as part of the country's cultural and social norms, noting that the general public typically did not have a high opinion of persons who achieved personal success through their own abilities.⁴⁰ The experts also believed that low entrepreneurial identification among Russian could be attributed to a lack of emphasis in the country's primary and secondary schools on

³⁷ Id.

³⁸ Id.

³⁹ Id.

⁴⁰ Id.

providing students with the knowledge and skills they would need in order to feel confident about starting a new business. Russia's education system was also criticized for a failure to encourage sufficient creativity, self-sufficiency and personal initiative, all traits thought to be useful and necessary for effective entrepreneurship.

In its 2013 assessment of the Russian economy, the World Bank recommended that the country needed to shift its policies toward greater support its startup companies as opposed to its SMEs in order to achieve its desired goal of diversifying its economy in the facing of slowing overall growth.⁴¹ The World Bank argued that supporting the creation of a robust Russian technology startup sector would ultimately benefit the larger Russian manufacturers by making them more competitive globally and thus less vulnerable to the economic slumps that Russia has continuously seen over the years. The World Bank acknowledged the commitment of the Russian government to diversify the country's economy and provide support for the country's SMEs in order for those firms to begin providing a larger percentage of the country's employment; however, it cautioned that "[i]f Russia is going to rely on new firms doing new things in new markets as a source of economic diversification, there will be a need to address volatility, competition and a too-heavy public policy and programmatic focus on small and medium-sized enterprises rather than on young, infant and productive firms".

§1:4 Characteristics of Russian entrepreneurs

Bain analyzed various aspects of the personal background and behavioral traits of prospective entrepreneurs in Russia's post-Soviet period and speculated that the capacity of individual to adapt to change, including engage in the pursuit of entrepreneurial activities in the private sector, depended to some extent on how much experience he or she had working under the old Soviet system. Younger people, for example, could be expected to be more adaptable since they were not as heavily influenced by the work customs of the Soviet era. Bain also noted that while the entrepreneurs in her study were roughly equally divided between men and women, she found that entrepreneurship in post-Soviet Russia was a male-dominated activity. She offered several possible reasons for this situation including long-standing gender expectations in Russia that placed "breadwinner" responsibilities on the male and the difficulties that confront women in Russia in gaining entry to the same sorts of social practices and norms, such as drinking, that men engage in and during which negotiations and exchanges that are so much a part of the informal business culture in Russia take place. As for personal character traits, Bain believed that the most significant ones for entrepreneurs in post-Soviet Russia were determination, perseverance, tenacity and optimism.

Djankov et al. conducted surveys in five large developing and transitional economies, including Russia, to identify the influence of various variables on entrepreneurship in those countries and found that, in general, entrepreneurial behavior in those countries was significantly impacted by perceptions of the local institutional environment, social

⁴¹ O. Ummelas, World Bank Urges Russia to Favor Startups over Small Businesses, Bloomberg News (September 25, 2013), <http://www.bloomberg.com/news/2013-09-25/world-bank-urges-russia-to-favor-startups-over-small-businesses.html> (accessed June 28, 2014).

network effects and individual characteristics of the entrepreneurs.⁴² With regard to Russia, which was the subject of its own separate pilot study by the researchers, they found that certain aspects of the institutional environment played an important role in determining the scope of entrepreneurship in that country; social networks played a significant role in determining who elected to choose an entrepreneurial path: individuals who had relatives or school friends who were entrepreneurs were themselves more likely to become entrepreneurs; and certain individual characteristics were important determinants of entrepreneurship such as educational background, performance on a test of cognitive ability, personal confidence, greed and willingness to take risks.

In their separate pilot study of entrepreneurship in Russia, Djankov et al. focused on identifying and explaining differences between entrepreneurs and non-entrepreneurs in that country.⁴³ They found that while there were no statistically significant differences between the two groups with respect to ethnicity or religious beliefs, the entrepreneurs scored significantly higher on various tests of cognitive ability, a finding that the researchers found to be consistent with the fact that a higher percentage of the entrepreneurs reported that they had been among the top 10% of their classes in secondary school. Members of the entrepreneurial group also scored higher than those in the non-entrepreneurial group with respect to number of previous professional activities, frequency of moving, income and wealth levels, propensity for risk-taking and belief that their work served a useful purpose. Another area in which Russian entrepreneurs differed from non-entrepreneurs was with respect to family background and the researchers found that family members of entrepreneurs were more highly educated, had better jobs and were wealthier. For example, the fathers of the Russian entrepreneurs were more likely to have been a director or a boss, as opposed to a worker, and a significantly higher percentage of the entrepreneurs' fathers were members of the Communist Party. Djankov et al. found that Russian entrepreneurship was positively correlated with higher educational background and that Russian entrepreneurs tended to have a more negative perception of the country's institutional environment than the general public.⁴⁴

When comparing cultural differences between Russian entrepreneurs and non-entrepreneurs, as well as the social norms found among each of those groups, Djankov et al. observed that while the entrepreneurs appeared to have a stronger work ethic and hunger for intellectual achievement and power, on balance there was no significant differences between the two groups with respect to the proportion of respondents believing that family, friends, leisure time, religion, service to others, financial security, health, and freedom were important.⁴⁵ Interestingly, entrepreneurs appeared to be more accepting of the common practice of paying and receiving bribes in Russia than the non-

⁴² S. Djankov, E. Miguel, Y. Qian and E. Zhuravskaya, "Who are Russia's Entrepreneurs?", *Journal of the European Economic Association*, 3(2-3) (April-May 2005), 1. The five countries surveyed were Brazil, China, India, Nigeria and Russia.

⁴³ Id. For a detailed review of the Russian pilot study, see S. Djankov, E. Miguel, Y. Qian, G. Roland and E. Zhuravskaya, *Entrepreneurship: First Results from Russia* (November 2004).

⁴⁴ S. Djankov, G. Roland, Y. Qian and E. Zhuravskaya, "Entrepreneurship in China and Russian compared", *Journal of the European Economic Association*, 4(2-3) (2006), 352.

⁴⁵ S. Djankov, E. Miguel, Y. Qian and E. Zhuravskaya, "Who are Russia's Entrepreneurs?", *Journal of the European Economic Association*, 3(2-3) (April-May 2005), 1.

entrepreneurs; however, the researchers suggested that the fact that entrepreneurs showed less concern about corruption might be attributed to their immersion in a business environment in which corruption was heavily embedded to the point where it had simply become an accepted and expected part of doing business in Russia.

Ojala and Isomäki conducted an extensive review of the then-available academic literature on entrepreneurship and small businesses in Russia and found that while the psychological characteristics of entrepreneurs in Russia were relatively similar to those of entrepreneurs in other countries, especially entrepreneurs in the US, there were distinct differences with respect to the educational level of Russian entrepreneurs and the business environment in which entrepreneurial activities were conducted.⁴⁶ Russian entrepreneurs relied heavily on non-material resources—social capital and network relationships, intellectual capital and available human resources—to overcome the significant financial and institutional obstacles that they needed to address in order to be successful in the marketplace. They noted that while there had been changes in government policies in Russia that had created expectations of increased entrepreneurial activity, the reality was that entrepreneurship and small businesses in Russia had continued to lag well behind the more successful Eastern European countries and that the articles they reviewed identified several lingering impediments to the growth and success of Russian entrepreneurs and their firms that had persisted throughout the period in which the reviewed articles had been published (i.e., 1998 through 2009) including environmental and institutional instability, high interest rates, inconsistent regulations and laws, the mafia, and corruption. Ojala and Isomäki noted that several articles compared Russian entrepreneurs to their counterparts in the US and found that, in general, the personal characteristics of entrepreneurs in both countries were relatively similar but Russian entrepreneurs had a lower educational level than US entrepreneurs, used more of their own capital, had fewer earlier entrepreneurial experiences and were more likely to be involved in the services sector than US entrepreneurs.⁴⁷

Bain explained the importance of social networking practices to the development of entrepreneurship in post-Soviet Russia and referred to the usage of a practice referred to as “blat”, which involved using personal contacts to obtain scarce resources which, in the context of entrepreneurial activities, included information and access to capital.⁴⁸ The Russian entrepreneurs that Bain interviewed as part of her study of entrepreneurship after the fall of the Soviet Union often thought of themselves as being vulnerable and viewed creation of, and participation in, social networks as an important strategy for both insulating themselves from the risks and insecurities of being an entrepreneur and preventing others from gain access to scarce resource and thus becoming competitors. Bain noted that reliance on blat was understandable given the overall situation and its firm place as part of Russian socio-economic culture during the Soviet era and that blat, which was essentially an unwritten code for getting things done more efficiently, made

⁴⁶ A. Ojala and H. Isomäki, “Entrepreneurship and small businesses in Russia: A review of empirical research”, *Journal of Small Business and Enterprise Development*, 18(1) (2011), 97.

⁴⁷ *Id.*

⁴⁸ C. Bain, *Entrepreneurship in Russia: Patterns and Problems of its Development in the Post-Soviet Period*, Ph. D Dissertation for University of Glasgow (July 2007), 21, 108-109.

intuitive sense as a means for dealing with the generally irrational and complex rules underlying the formal system in Russia. However, Bain pointed out that the reliance on blat among the entrepreneurial community meant that success depended not so much on the entrepreneur's ability to identify, refine and execute innovative ideas but more on his or her ability to successfully understand the rules associated with blat and apply them in a manner that created a competitive advantage for their businesses. Moreover, it was not readily apparent how new entrepreneurs could learn how to be adept at blat since there were no hard and fast rules and no school to attend and the actual learning process took time, meaning that the entrepreneurs were particularly at risk during the early stages of their businesses and under a lot of pressure to learn the rules as quickly as possible in order to survive.

Bain saw the reliance on personal contacts to acquire scarce resources among Russian entrepreneurs as an attempt by those entrepreneurs to personalize the formal system and the exchanges that must be made in that system in order for businesses to survive and argued that personalizing such exchanges was necessary in post-Soviet Russia because entrepreneurs lacked trust in the country's formal institutions and believed that engaging in close and personal exchanges would be a good strategy for reducing risks.⁴⁹ What this meant, however, is that business success in post-Soviet Russia often depended on who the entrepreneur knew—his or her personal networks—than the quality and pricing of the goods and services that he or she was offering. Bain noted that this not only made it difficult for new entrants, since entrepreneurs seeking access to a particular scarce resource often needed to deal with officials who had already established network relations with other entrepreneurs, but also led to the development of negative stereotypes of entrepreneurs, who were often seen as being involved in corrupt activities and thus not be trusted by the general public. The public's skepticism regarding entrepreneurship was also included by the fact that a number of those engaged in entrepreneurial activities traded on pre-existing personal or familial relationships with government officials that were not generally available to all persons interested in starting new businesses.

§1:5 Efforts to develop an entrepreneurial ecosystem

The Russian government has launched a variety of initiatives to provide financial support to startups including state-controlled investment entities (e.g., Russian Corporation of Nanotechnologies and the Russian Venture Corporation) that provide funding directly to startups, tax concessions for companies with business models highly dependent on intellectual capital and/or operating within one of the country's special innovation clusters such as Skolkovo, which is described in further detail below, and tax holidays for investors upon sale of shares in Russian high technology companies if certain conditions are satisfied.⁵⁰ While not always directly related to funding for startups, the Russian government has also actively pursued development of the country's private equity (PE)

⁴⁹ Id. at 111.

⁵⁰ A. Dvornikova, M. Sendra and O. Loy, *Enabling Startups and Innovation in Russia and US*, http://www.law.berkeley.edu/files/bclbe/Enabling_Startups__Innovation_in_Russia_and_US_Loy.pdf (accessed June 23, 2014).

sector by launching its own fund to invest in domestic PE opportunities and attract international investors.

Among the key organizations supporting startups in Russia as of 2011 were Skolkovo, the government sponsored technology cluster in Southwest Moscow with 169 residents and 900 candidates, Zvorykin, with 7,500 projects in its database, the Russian Venture Company, which was managing 12 venture funds that had invested in over 75 startups, and the foundation of Assistance to Small Innovative Enterprises, which claimed to have 9,000 financed projects and 25,000 projects in its database.⁵¹ The most popular sectors among the organizations involved in supporting Russian startups were energy, IT, biomedical, nuclear and space, and the types of support included consulting, financing grants, co-financing with private investors for expansion stage activities, events and investment directly into seed and venture capital funds. Support for startups also came from various technoparks around Russia such as Ingria in St. Petersburg and the IT Park located in Kazan, the capital of the Republic of Tatarstan. Henni reported that Ingria, located in St. Petersburg, had over 70 resident companies that employed more than 500 people in various technological fields.⁵² Henni reported that the IT Park in Kazan was one of the largest technoparks in Eastern Europe and also plays host to a vibrant and popular business incubator.⁵³

Smallbone and Welter argued that Russian entrepreneurs had often used political influence and connections as a means for pursuing and achieving private gain.⁵⁴ Degeler reported on various aspect of government involvement in Russia's entrepreneurial ecosystem and noted that many entrepreneurs acknowledged the need to establish and maintain good relations with government officials even as the development of the startup community in Russia is being touted for diverging from past practices and emphasizing the wisdom of private markets.⁵⁵ One Russian entrepreneur interviewed by Degeler pointed out that while founders must necessarily launch their businesses in a relatively isolated, and somewhat secretive manner, in Russia it inevitably becomes necessary to engage with governmental authorities at some level and at that point founders must be prepared to be transparent and deal patiently with a state apparatus that still has a negative impression of entrepreneurs even as the government has been throwing lots of money toward technology-based startups. The entrepreneur admitted that engagement with government officials can be difficult or the founders of a technology startup since they quickly find that the officials have little idea what the companies are doing and how they are organized. In addition, entrepreneurs usually view interaction with government officials as stressful since there are legitimate concerns that those officials can take actions, or without approvals, without justification or due process and cripple the hopes of the founders for their new businesses.

⁵¹ The Moscow News, Key Organizations Supporting Startups in Russia (May 10, 2011).

⁵² A. Henni, How to Invest in Russian Startups, Russia Beyond the Headlines: Russian Start-Ups, http://rbth.com/startups/investors_guide (accessed June 25, 2014).

⁵³ Id.

⁵⁴ D. Smallbone and F. Welter, "The Distinctiveness of Entrepreneurship in Transition Economies", *Small Business Economics*, 16 (2001), 249, 252.

⁵⁵ A. Degeler, Startups in Russia: Why you really can't ignore the Kremlin, for better or worse, <http://thenextweb.com/insider/2014/06/17/startups-russia-government/> (accessed June 27, 2014).

A number of researchers from the US have been interested the combined influence of individual characteristics, social networking effects and the institutional environment on the actions and behaviours of Russian entrepreneurs.⁵⁶ Several of them have argued that Russian entrepreneurs, like Russians in general, have a low level of trust in the country's governmental and public institutions and consider them to be unreliable and unpredictable.⁵⁷ At the same time, Russians tend to have high levels of trust in their interpersonal networks and thus it can be expected that Russian entrepreneurs will rely heavily on their social connections when engaging in business activities as a means for mitigating risk and insulating themselves against the constant wave of changes in the macro-environment in which they are operating.⁵⁸ Ojala and Isomäki commented that the high levels of institutional instability in Russia contributed to the large number of informal and unregistered entrepreneurial firms in Russia.⁵⁹

§1:6 Foreign investment in Russian startups

Entrepreneurs and small firms in Russia has consistently had to deal with higher information costs than established companies and their expansion has been more related to the availability of internal funding due to the shortcomings in Russia's credit markets and the lack of security in property rights that have tended to discourage traditional lenders from advancing funds to new businesses.⁶⁰ Schenker reported in mid-2000s on the increased interest of foreign venture capitalists in Russian technology startups and noted that well-known venture funds from the US and Western Europe, as well as the venture capital arms of multinational companies such as Cisco Systems, have made investments in promising companies in Russia and Central and Eastern Europe.⁶¹ While foreign venture capitalists were willing to put their own money at risk in Russia, the government took the initiative to encourage investors by offering to provide matching funds which could be used to set up new investment vehicles that would specialize in various business sectors. In fact, several US venture capitalists elected to partner with Russian venture capital funds and/or seasoned and successful Russian entrepreneurs to create new investment programs, a strategy that effectively combined local knowledge with experience in building global technology companies.

⁵⁶ B. Batjargal, "The dynamics of entrepreneurs' networks in a transitioning economy: the case of Russia", *Entrepreneurship and Regional Development*, 18 (2006), 305; and S. Djankov and E. Miguel, "Who are Russian Entrepreneurs?", *Journal of the European Economic Association*, 3(2-3) (2005), 1.

⁵⁷ B. Batjargal, "Social Capital and Entrepreneurial Performance in Russia: A Longitudinal Study", *Organization Studies*, 24(4) (2003), 535; and S. Rose-Ackerman, "Trust and Honesty in post-socialist societies", *Kyklos*, 54 (2001), 414.

⁵⁸ B. Batjargal, "Social Capital and Entrepreneurial Performance in Russia: A Longitudinal Study", *Organization Studies*, 24(4) (2003), 535; and B. Butler and S. Purchase, "Use of Social capital among Russian managements of a new generation", *Industrial Marketing Management*, 37 (2008), 531.

⁵⁹ A. Ojala and H. Isomäki, "Entrepreneurship and small businesses in Russia: A review of empirical research", *Journal of Small Business and Enterprise Development*, 18(1) (2011), 97.

⁶⁰ Id.

⁶¹ J. Schenker, *Russia's Venture Capital Boom: Tech Startups Come of Age*, *Business Week*, <http://www.spiegel.de/international/business/russia-s-venture-capital-boom-tech-startups-come-of-age-a-485390.html> (accessed June 28, 2014).

Dvornikova et al. identified advantages of investing in Russian startups as including the fact that Russia has the largest Internet and mobile market in Europe, as well as growing opportunities in other high-tech sectors such as software, nanotechnologies, clean tech and biomedicine; a large and, at least through 2010, fast growing consumer market; a high level of science and technology; lower labor costs, at least outside of Moscow; and strong entrepreneurs and a quickly developing entrepreneurial ecosystem.⁶² As for disadvantages of making investments, they noted corruption and bureaucracy and shortcomings, at least in relation to the US and Western European countries, with respect to finance and marketing.

The number of Internet users in Russia has grown rapidly over the last decade and the resulting boom in e-commerce has created tremendous opportunities for Russian entrepreneurs and it is expected that local companies will be moving aggressively into online gaming and pursuing innovations in finance as Russian consumers accelerate their acceptance and use of credit cards.⁶³ The government also announced plans to provide fiber broadband to every city, town and village in Russia with more than 250 people, an enormous undertaking in a country as large as Russia.⁶⁴ Figures compiled and released by Fast Lane ventures based only on publicly disclosed transactions showed that \$2.17 billion was invested in Russian Internet startups in 2011, a 70% increase from the previous year.⁶⁵

As with most developing and emerging countries, identifying legitimate and promising investment opportunities among startups is a challenge in Russia and attempts have been made to address this issue by creating databases, conducting contests and developing media outlets that focus on startup news. One interesting tool is the Russian Startup Rating introduced by “Russia Beyond the Headlines”, which is an attempt to provide an objective assessment of the development level and dynamics of young Russian technology companies.⁶⁶

Henni suggested that Western investors looking for potential startups in Russia can take advantage of a growing number of technology-oriented contests, databases and media outlets that have become showcases for Russian entrepreneurs and their new business ideas. Western investors can also tap into the contacts and expertise of local venture capitalists and co-invest with them in promising Russian opportunities.⁶⁷ Henni noted

⁶² A. Dvornikova, M. Sendra and O. Loy, Enabling Startups and Innovation in Russia and US, http://www.law.berkeley.edu/files/bclbe/Enabling_Startups__Innovation_in_Russia_and_US_Loy.pdf (accessed June 23, 2014).

⁶³ M. Venkataramanan, “Europe’s Hottest Startup Capitals: Moscow”, *Wired* (October 1, 2013).

⁶⁴ B. Glick, Russia’s investment in tech startups depends on overcoming concerns of its new web-savvy generation, *Computer Week* (June 5, 2014), <http://www.computerweekly.com/blogs/editors-blog/2014/06/russias-investment-in-tech-sta.html> (accessed June 27, 2014).

⁶⁵ A. Henni, How to Invest in Russian Startups, *Russia Beyond the Headlines: Russian Start-Ups*, http://rbth.com/startups/investors_guide (accessed June 25, 2014).

⁶⁶ A. Dvornikova, M. Sendra and O. Loy, Enabling Startups and Innovation in Russia and US, http://www.law.berkeley.edu/files/bclbe/Enabling_Startups__Innovation_in_Russia_and_US_Loy.pdf (accessed June 23, 2014).

⁶⁷ A. Henni, How to Invest in Russian Startups, *Russia Beyond the Headlines: Russian Start-Ups*, http://rbth.com/startups/investors_guide (accessed June 25, 2014).

that dozens of technoparks, incubators and accelerators have been launched in Moscow and in other parts of Russia in recent years and that many of them have taken a particular interest in attracting foreign investors that might have an interest in meeting local entrepreneurs and perhaps supporting their companies.⁶⁸ Some of the accelerators have close working relationships with accelerators in the US and the UK that have created opportunities for Russian entrepreneurs to travel to more developed innovation hubs around the world. The technoparks, including Skolkovo, have benefitted from massive levels of government subsidies and tax breaks and Henni commented that they have been a magnet for both global venture capital funds and technology-focused multinational corporations seeking access to Russian attempts to create new technology that might be commercially viable.

Henni reported that large amounts of money have become available for investment in Russian startups over the last few years and that there is particular interest in forming and operating venture capital funds specializing in the IT sector.⁶⁹ Henni noted that while Russian entrepreneurs have been quick to embrace Western concepts of business formation and operation, often having degrees from colleges and universities in the US or Western Europe, many of them are young and lack actual experience working in a startup environment.⁷⁰ Henni noted that the relatively low labor costs, in comparison to Silicon Valley, for talented local engineers, programmers and other professionals has been one of the main reasons that foreign investors have been interested in Russian startups.⁷¹ While the highest salaries among Russian startups are found among the companies launched in Moscow, engineers at those firms still make no more than 25%-30% of the salaries that must now be offered by companies seeking to be competitive in Silicon Valley and qualified engineers willing to accept lower salaries can be found in other less pricey cities around Russia such as Tomsk, which has a large number of residents studying at or working with the Russian Academy of Scientists.

Henni reported that the general perception is that Russian tech startups are far more transparent than the country's traditional oil and gas enterprises and that corruption is much less of an issue for Russian entrepreneurs since the country's civil servants often have difficulty understanding what tech companies do and how they might be taken advantage of.⁷² Transparency also follows from the fact that the value of Russia's new technology companies depends largely on the skills and ideas of their founders and employees rather than on obtaining regulatory approvals. Nonetheless, Henni noted that many investors, both foreign and Russian, prefer to have the startups in which they invest incorporate in Western jurisdictions in order to have greater certainty with respect to the rules relating to corporate governance, particularly shareholders' rights, and protection of intellectual property rights. Henni counseled that it is extremely important for foreign investors to have a physical presence in Russia in order to make the most effective investment decisions and noted that dozens of international venture capital firms had

⁶⁸ Id.

⁶⁹ Id.

⁷⁰ Id.

⁷¹ Id.

⁷² Id.

already set up offices in Russia or at the very least had established and maintained a rigorous schedule of frequent visits to Russia.⁷³

Dvornikova et al. observed that foreign investors interested in providing funding for Russian startups would probably do best by co-investing with Russian venture capital funds, most of which are duly concerned about their reputations and striving to achieve and maintain international standards.⁷⁴ Partnering with knowledgeable local investors eases the challenges that foreigners might otherwise have in dealing with relatively inexperienced Russian entrepreneurs who often have poor English language proficiency. In addition, co-investing is often necessary due to lingering restrictions on investment in certain strategic sectors (e.g., oil, gas and defense) that make it impractical to seek and expect government approvals without the involvement of a local investor. Local investors also have a better understanding of domestic licensing requirements, tax laws and rules relating to ownership and use of land. Finally, foreign investors must realize that exit opportunities are not as developed or efficient as they are in the US. Russia's capital markets are still developing and foreign investors should expect to look to sales of their shares to strategic buyers, including Western companies looking to gain a foothold in the Russian market, or other venture capital or private equity funds. The lack of exit opportunities for investors in Russian startups make it imperative that investors identify and choose the most promising companies in specific sectors, since the chances of those firms being acquired are much higher than for also-rans competing in the same sector

A Russian entrepreneur interviewed by Degeler felt that one of the problems with the speed of development of the Russian entrepreneurial ecosystem was the lack of experienced and knowledgeable Russian technology investors and this situation has made it even more important for Russian entrepreneurs to access investors in the US and Western Europe who understand their technologies and can provide practical and specific advice on how to build their businesses.⁷⁵ While a number of Western investors had shown interest in providing the necessary support for Russian startups their interest has been understandably dampened by perceived political and economic instability surrounding Russia since the onset of the crisis in Ukraine.

§1:7 Skolkovo: Russia's Silicon Valley

Skolkovo is the site of the "Inograd," or innovation city, which was established with the goal of becoming the Silicon Valley of Russia and the home for large numbers of engineers, programmers, mathematicians and physicists collaborating under the guidance of bright, young and savvy businesspeople trained nearby at the Skolkovo Moscow

⁷³ Id.

⁷⁴ A. Dvornikova, M. Sendra and O. Loy, *Enabling Startups and Innovation in Russia and US*, http://www.law.berkeley.edu/files/bclbe/Enabling_Startups__Innovation_in_Russia_and_US_Loy.pdf (accessed June 23, 2014).

⁷⁵ A. Degeler, *Startups in Russia: Why you really can't ignore the Kremlin, for better or worse*, <http://thenextweb.com/insider/2014/06/17/startups-russia-government/> (accessed June 27, 2014).

School of Management.⁷⁶ It was hoped and predicted that Skolkovo would become the birthplace of Russia's own high technology sector and that technology-based innovation would assist in facilitating a badly needed diversification of a national economy that had become overly dependent on oil, gas and other natural resources. Several global technology companies, including Intel and Cisco, were early public supporters of the Skolkovo project.

Skolkovo is the latest example of state-sponsored innovation in Russia, a sequence of initiatives that have spanned decades and included investment of massive amounts of financial and human resources in the development of nuclear weapons and other national security tools and assets. When plans for the Inograd were first announced in March 2010, the government indicated that over \$4 billion would be invested in the project over the first three years and hundreds of laws would be amended to facilitate and encourage investment in Skolkovo. Inograd was to be overseen by the Skolkovo Foundation, which would be responsible for providing incubator facilities and services as well as being an important source of seed capital and later stage financing for businesses that showed promised and developed a prototype that had attracted the interest of strategic partners.

According to Savodnik the Skolkovo Moscow School of Management, established and operating just outside of Moscow, was designed to train the first generation of non-oligarchical Russian capitalists, entrepreneurs who are focused on creating wealth through launching new innovative businesses rather than by seizing and selling assets that were formerly owned by the Russian state.⁷⁷ It was intended that the business school operate in a manner similar to Stanford University in the Silicon Valley; however, the initial curriculum lacked courses in business ethics. The business school has also partnered with MIT, which welcomes Skolkovo students for two months in the US to study entrepreneurship.

Savodnik cautioned, however, that all of the investment in Skolkovo might well be for naught unless and until Russia is able to make substantial changes in its legal and business environment for entrepreneurship.⁷⁸ For example, in rankings compiled and published by the World Bank in 2010 Russia ranked 123rd out of 183 countries with respect to ease of doing business. Savodnik predicted that smart Russian entrepreneurs with a viable product and business model would quickly emigrate to the US, Europe or Israel to build their dreams in an environment where intellectual property rights were respected and protected and businesspeople did not have to live in constant fear or strong-arming by local mobsters or government officials.

Degeler interviewed a Russian entrepreneur who praised the government's attempt to support startups through the formation of Skolkovo yet also pointed out that the initiative

⁷⁶ P. Savodnik, Skolkovo: Russia's Would-Be Silicon Valley, *Business Week* (September 1, 2011), <http://www.businessweek.com/printer/magazine/skolkovo-russias-wouldbe-silicon-valley-09012011.html> (accessed June 24, 2014).

⁷⁷ Id.

⁷⁸ P. Savodnik, Skolkovo: Russia's Would-Be Silicon Valley, *Business Week* (September 1, 2011), <http://www.businessweek.com/printer/magazine/skolkovo-russias-wouldbe-silicon-valley-09012011.html> (accessed June 24, 2014).

has not been effective as it might have been due to the failure of the government to identify and select the right people to manage the project.⁷⁹ According to the interviewee, the government “tried to hire the best people, paid them huge salaries, but those people were just not motivated enough — they didn’t have a core agenda in their lives that is about improving the tech industry”. Other problems within the management group at Skolkovo included a lack of diversity—“too male-dominated” according to the entrepreneur interviewed by Degeler—and a lack of understanding of the technologies being developed by the startups. The entrepreneur also argued that companies that received grants as part of the Skolkovo initiative were handicapped by a lack of support on how the companies should be operated and the funds strategically deployed and that the founders of those companies often treated the grants as “free money” that was useful but that came without the sense of urgency that accompanies financing from venture capitalists that apply pressure on the founders from the day of investment to execute the business model and generate the anticipated return on investment for the venture capitalists and other stakeholders.

According to Glick, the Skolkovo initiative was a bold and costly effort to create, within a five year period, “a small town on the outskirts of Moscow with office space, R&D facilities, a technology university, and residential properties for students, startup workers and their families”, all of which was to be connected to the Moscow metropolitan area by a new railway line.⁸⁰ Glick provided a description of some of the details of the Skolkovo program including opportunities for Russian startups interested in demonstrating an international outlook to obtain up to \$10 million in non-refundable grants and significant tax incentives, perquisites that attracted such a large number of applicants that it was expected that only one of every six candidates would be accepted and only a quarter of those companies accepted would receive grants based on reviews by a panel of Russian and non-Russian experts.⁸¹ One of the anticipated benefits of the Skolkovo program was the creation of new role models for Russian entrepreneurs in response to concerns that Russia’s lack of “success stories” was holding back its progress toward building an entrepreneurial ecosystem similar to Silicon Valley. It was hoped that founders of successful Russian startups would not only serve as mentors to other entrepreneurs but also provide badly-needed seed capital of the type typically provided by angel investors in the US and in many parts of Western Europe.

Glick noted that while many young Russian entrepreneurs welcome the support, financial and otherwise, being offered by the government through initiatives such as Skolkovo, they also have a different life experience than their parents and have a more global outlook that pushes them to look outward and consider setting up their businesses outside of Russia in areas where economic and social freedoms are greater and state regulation is minimized.⁸² According to Glick, “the younger, internet-savvy generation see a

⁷⁹ A. Degeler, Startups in Russia: Why you really can’t ignore the Kremlin, for better or worse, <http://thenextweb.com/insider/2014/06/17/startups-russia-government/> (accessed June 27, 2014).

⁸⁰ B. Glick, Russia's investment in tech startups depends on overcoming concerns of its new web-savvy generation, *Computer Week* (June 5, 2014), <http://www.computerweekly.com/blogs/editors-blog/2014/06/russias-investment-in-tech-sta.html> (accessed June 27, 2014).

⁸¹ Id.

⁸² Id.

government that controls the media, restricts web freedoms and relies on billionaire oligarchs” and this has created real doubts among young Russian entrepreneurs regarding the ability of Russia to actually become a global technology player.

Glick pointed out that while the scope of the Skolkovo initiative is impressive and there would seem to be little doubt that its success would be widely welcomed throughout Russia, the reality is that it will take decades before its impact can be accurately accessed.⁸³ It is clear that the Russian government has always understood the importance of technology but supporting the creation of a system in which much of the technology will be deployed for commercial purposes by private firms outside of the direct control of the state is something very new and different and it can be expected that the coming years will bring a lot of ups and downs and growing pains while the innovation engines in Silicon Valley and elsewhere in the developed world are steadily moving forward at a rapid pace and new competitors to Russia are emerging from the developing countries.

§1:8 Leadership

Gratchev et al. argued that an understanding of leadership in the context of post-Soviet Russian business culture must take into account the fragmentation of managerial corps and cultural clusters following decades of Soviet universalism and what they perceived to be a visible shift in public attention in Russia toward business leadership influenced by media coverage. Using the GLOBE dimensions, Gratchev et al. observed that “the profile of an effective leader in Russia was an “administratively competent manager with abilities to think strategically, capable to make serious decisions and inspire his followers to meet performance targets”.⁸⁴ Gratchev et al. went on to explain: “To a certain extent he/she relies on teams and through diplomatic and collaborative moves succeeds in integrating efforts of their members. However, in his/her actions there is not much interest in humane orientation to the others and modesty in personal behavior. He/she may sacrifice a lot and does not take much care of saving face. Status is not important to the modern Russian leader.” Ambrozheichik set out to formulate a composite profile of Russian organizational leadership based on an extensive review and analysis of research conducted since the mid-1990s by both Russian and Western scholars and concluded: “A leadership profile that will be culturally accepted, enacted and effective in Russia will reflect: a moderate focus on term development and collective implementation of a common goal, with emphasis on administrative competence; lack of participative leadership, low involvement of subordinates in decision making, an autocratic orientation; and a preference for charismatic behavior, inspirational and motivational ability, achieving high performance through shared core values.”⁸⁵

⁸³ Id.

⁸⁴ M. Gratchev, N. Rogovsky and B. Rakitski, Leadership and Culture in Russia: The Case of Transitional Economy, GLOBE Project Materials, http://www.fh-fulda.de/fileadmin/Fachbereich_SW/Downloads/Profs/Wolf/Studies/russia/russia_chapter_tc4.pdf (accessed July 6, 2014), 20.

⁸⁵ G. Ambrozheichik, “Cultural Profile of Russian Leadership”, International Journal of Leadership Studies, 6(3) (2011), 310, 323.

Ojala and Isomäki reviewed several academic articles published between 1993 and 2009 that focused on managerial styles and practices of Russian entrepreneurs and found that Russian entrepreneurs were likely to use their peers rather than their subordinates in collective decision making and typically exhibited inspirational and charismatic leadership behavior as opposed to the passive and laissez faire leadership style typically found among managers of larger Russian firms.⁸⁶ Russian entrepreneurs were also adept at adapting their management practices to changes in their operating environment, an important skill given the high levels of economic and institutional instability in the Russian entrepreneurial ecosystem.

§1:9 Organizational design

The study of organizational structure in Russia requires an understanding of the influence of a long history of state control, remnants can still be seen within former government owned and controlled enterprises that have been privatized, and the emergence of a new entrepreneurial class of managers with ideas and motivations that are strikingly Western.⁸⁷ Societal culture appears to have a strong explanatory value when assessing preferences regarding organizational structure among Russian enterprises and the unpredictability in the economic and political environment also plays a role. Researchers have typically found Russian culture to be high on both “power distance” and “uncertainty avoidance”, a situation which has led to a preference for vertical organizational structures characterized by top-down management and communications channels and complex and formal bureaucracies. Traditionally governmental power and influence, as well as the location of investment opportunities, has been centralized within Russia and the high power distance found in firms is mirrored in the large gaps in wealth found within the broader Russian society. When searching for clues regarding Russian preferences with respect to organization structure Wursten identified a “pyramid” model based on a combination of loyalty, hierarchy and implicit order, and suggested that this model was suitable for collective societies with high scores on power distance and uncertainty avoidance such as Russia.⁸⁸

An interesting study by Denis and Chun-sheng identified the following eight organizational structures in Russia, China and Canada: vertical functional structure, simple matrix approach, network structure, command approach, virtual horizontal team, learning organization and reengineering.⁸⁹ For Russia, they found that the vertical organizational structure prevailed (57%), followed by the vertical divisional structure

⁸⁶ A. Ojala and H. Isomäki, “Entrepreneurship and small businesses in Russia: A review of empirical research”, *Journal of Small Business and Enterprise Development*, 18(1) (2011), 97.

⁸⁷ A limited survey of influences on organizational structure is available from T. Dahlen and A-C. Forsman, *Organizational Structures in Emerging Markets: Cases from Multinational Telecommunications Firms in Russia* (2004).

⁸⁸ For further discussion, see H. Wursten, *Culture and Change Management*, ITIM Culture and Management Consultancy, <http://www.itim.org/articleonchangemanagement.pdf>. Measures of Russian societal culture generally find evidence of “collectivism” based on scores on the individualist-collectivist dimensional pole.

⁸⁹ P. Denis and S. Chun-shen, *Comparing Organizational Structure of Management in Canadian, Russian and Chinese Enterprises* (2009).

(30%), and that there was little interest in any of the other alternatives. The researchers speculated that one reason for this was that the contemporary Russian organizational system was inherited from the Soviet model, in which administrative planning prevailed. In 1990s, there were a number of attempts to introduce the American model, but the majority of them were far from successful, in large part because of the Russian mentality, which resists copying and transfer (as was successfully done in China) and the absence of theoretical bases rooted in market economy.

The strong centralization of power continues to be reflected in the organizational structure of Russian companies, where even very minor issues tend to be solved by direct participation of top management. This is one reason why innovative and perspective organizational schemes, such as sample matrix approach, command approach, learning organization and reengineering are little used by Russian companies. A second reason could be absence of performance indicators at enterprises. Another reason is that most offices and departments that create or control organizational structure in Russian enterprises have not been ruled by professional managers. Instead, they are typically managed by old-style human resource offices (cadre departments), or, in other cases, by senior managers who have been with the companies for a long period of time.

Kyrki and Kortelainen found the Russian economy to be “insider-dominated” and noted that this applied to Russian enterprises, which they described as manager-dominated.⁹⁰ Kyrki and Kortelainen also observed that Russian managers have become an important owner group due to the privatization program that has been underway in Russia over the last few decades and that owner-managers have generally adopted a cautious attitude toward outside investors and bank credit due to concerns about how financing from these sources might limit managerial power and discretion. Sutela commented that this situation has resulted in limited outside equity and debt as well as a lack of structural change and growth.⁹¹

In a 2013 article in *The Moscow Times* it was reported that top recruitment consultants in Russia continued to see remnants of historical practices of reliance on a single, dominating boss who made almost every decision regarding firm operations.⁹² The consultants expressed concern that while this approach might be appropriate and effective for smaller businesses it was becoming less and less suitable for rapidly growing companies reliant on the skills and satisfaction of a new generation of talented and knowledgeable workers who could be expected to chafe under an organizational structure where there were large gaps between decision makers and others in the company, a lack of authority among middle managers to create and maintain productive conditions and delays and misunderstandings due to miscommunication and lack of feedback. Middle managers often responded to their lack of authority by abandoning efforts to assume

⁹⁰ A. Kyrki and S. Kortelainen, The Key Success Factors in Distributed Product Development–Case Russia, *Frontiers of E-Business Research* (2006).

⁹¹ P. Sutela, Economic Transition in Russia, in K. Liuhto (Ed.), *Ten Years of Economic Transformation, Volume 1 – The Economies in Transition and EU Enlargement*, 16 Lappeenranta University of Technology, *Studies in Industrial Engineering and Management* 187 (2001).

⁹² M. Gay, Vertical Power Structure May Prove a Weak Point for Russian Companies, *The Moscow Times* (April 18, 2013).

responsibility and take the initiative and relationships between senior executives and managers were characterized as “tenuous” in all types of enterprises—owner-operated, privatized firms and state corporations. An interesting observation was that top managers in Russia often had divided loyalties and interests that distracted them from focusing on the best interests of their firms and employees. Specifically, Russian executives, particularly among the state corporations, were often more concerned with their place within the administration of the Russian Federation and took orders from political officials in order to ensure their personal advancement and survival within the broader political-economic ecosystem. Other factors in play included a long tradition of low levels of trust between superiors and subordinates and the inexperience of Russian with developing and maintaining a business culture.

§1:10 Organizational culture

Corporate culture is a relatively new, and unfamiliar, concept among Russian businesses. Kalashnikova commented that “Russia’s corporate culture is young, ambitious and dynamic but often anarchic”.⁹³ Kalashnikova also catalogued various characteristics of emerging organizational culture in Russia as businesses become more and more exposed to outside influences while still struggling to reconcile traditional local cultural values: impulsiveness and uncertainty, bordering on anarchy, often seem to rule activities and behaviors in Russian organizations, as opposed to the transparent standardized practices typically found inside US and European companies; responsibility for decisions generally remains vested with a single person at the top of the organizational hierarchy; organizational structures are generally quite hierarchical and status is quite important to managers who generally seek to build and maintain both physical and emotional walls between themselves and their subordinates; and evaluation of job performance and staff development procedures lack transparency and this leads to distrust of managers among subordinates, particularly with regard to the fairness of promotions.

Based on Hofstede’s dimensions of societal culture Russia has extremely high power distance and uncertainty avoidance and low individualism and masculinity.⁹⁴ According to Kliuchevskii Russians have tendencies toward resourcefulness, patience under adversity, deprivation and spurts of energy and tend to have difficulties in seeing things through to completion.⁹⁵ These traits of Russian societal culture can be seen in studies of Russian organizational culture such as the work Vlachoutsicos and Lawrence that uncovered good vertical flow of information in Russian firms, but poor horizontal flow from department to department, a situation they attributed to the belief that information represented power and thus not to be shared even though this impaired efforts to achieve coordination and integration.⁹⁶ Interestingly Fey and Denison found that adaptability and

⁹³ O. Kalashnikova, *Organizational Culture: Russian Style*, *The St. Petersburg Times* (April 3, 2013).

⁹⁴ G. Hofstede and G.J. Hofstede, *Cultures and Organizations; Software of the Mind* (2nd Ed. Rev.) 112 – 117 (2005).

⁹⁵ F. Ozer, *The Relationship Between Organizational Culture and Firm Performance: A Cross-Cultural Study among Turkey, Russia and Romania*, 4(2) *International Journal of Social Sciences and Humanity Studies* 207, 209 (2012) (citing V. Kliuchevskii, *Kluhevskii’s Collected Works* 34 (1990)).

⁹⁶ C. Vlachoutsicos and P. Lawrence, *What We Don’t Know about Soviet Management*, 68 *Harvard Business Review* 50 (November-December 1990).

involvement were both highly important to organizational effectiveness among foreign-owned firms operating in Russia.⁹⁷

Groznaya argued that the business and organizational culture driving Russian firms is complex because it includes elements from a variety of sources including traditional Russian values running back to the 19th century, practices learned through the extended period of Communist rule and control during much of the 20th century and values that are entering Russia as it increases its exposure to the West and multinational Western companies.⁹⁸ Groznaya pointed to three factors that have been particularly influential with respect to Russian business culture: “the unique geographic position and environment that has forced people to adjust to unpredictable and often severe climate conditions . . . [and] has created a collectivist, enduring and fatalistic mentality . . . the Orthodox Christian ethic that emphasized forbearance, obedience and strict hierarchy . . . [and] the rapid historical changes of the 19th century partly destroyed the previous culture and brought to life a new, communist and later post-communist mentality”.

Groznaya described “three co-existing cultures [in Russia] that partly collide and partly merge with each other”. The first of these cultures is represented by the outlook taken by the “technocrats”, who were described as technical experts and managers with basic technical education who continue to play an important role in managing strategically important state-controlled enterprises after the end of Communist rule. While the technocrats have been well trained in their technical areas Groznaya commented that: “Traditionally they lack any formal management education . . . Being brought up in the communist society, technocrats tend to practice a collectivist, hierarchical, paternalistic work style. In order to avoid any risk and unpredictability, they are formal and bureaucratic. Consequently, Russian organizations run by technocrats are notorious for having many rules and regulations.” Post-Communist firms managed by technocrats tend to have a vertical hierarchical structure with top-down decision-making and limited, if any, flow of communication and information between different levels in the hierarchy and/or across horizontal business units. In fact, information is perceived as a proprietary asset useful for political purposes and thus is not something to be shared. Managers and employees see their roles as knowing what they are supposed to do and simply doing it without asking questions or suggesting different approaches.

The second Russian business culture described by Groznaya was based on the first generation of “Russian entrepreneurs” who emerged after the end of Communist rule to begin construction and development of a new private business sector. Groznaya described these individuals as “inventive, flexible and risk-taking” and noted that many of them were negatively perceived in the public eye due to the belief, often mistaken, that they had achieved financial success through illegal means. The new Russian entrepreneurs needed to act quickly and decisively in a rapidly changing business

⁹⁷ C. Fey and D. Denison, *Organizational Culture and Effectiveness: The Case of Foreign Firms in Russia* 101-102 (1999).

⁹⁸ The discussion of the commentary given by Groznaya in the following paragraphs, as well as the quotations, are adapted from E. Groznaya, *Conflict of Generations: Business Culture of Contemporary Russia*, *TC World* (June 2009).

environment and tended to take a pragmatic approach. The turbulent environment, combined with a fatalism inherited from prior generations, caused these entrepreneurs to askew long-term strategic planning and adopt a more relaxed and flexible approach toward time and time commitments. As for rules and regulations applied to their business activities, Russian entrepreneurs admittedly were ready and willing to ignore them in favor of an “ends justify the means” approach to achieving market success. Groznaya commented that the Russian entrepreneurs who started their businesses in the early 1990s were less formal and more direct in operating their firms; however, those firms retained the vertically-organized hierarchy traditionally found in Russia along with a managerial culture that was still “characterized by high power distance and a strong collective mentality” and relied on a “paternalistic leadership style”.

The third and final Russian business culture described by Groznaya is clearly quite intriguing and is represented by what was called the “young post-perestroika generation” and described as “highly educated, often Western-oriented professionals” who bring to Russian business distinct Western work and management styles. This group brings a number of new and different characteristics when compared to their predecessors in the continuum of Russian management including a respect for punctuality and task orientation, informality, egalitarianism and commitment to contractual obligations. However, they also have continued some of the practices of the past including reliance on hierarchically-structured negotiating teams, a preference for short-term planning (with such planning made in a top-to-bottom fashion), limited information flows within the organization and relatively little consultation in advance of important decisions. Paternalistic and charismatic leadership remains important even in the newest of Russian business ventures.

Fey et al. followed a similar line of thought my noting that the development of a market economy—a dramatic change in course—following the the collapse of the Soviet Union left a large part of the work force in confusion, with little understanding of the new framework to be used, and suggesting that the result has been the rise of two different organizational cultures in Russia today: one a residue of the Soviet system, and the other Western-influenced.⁹⁹ They noted that effectively managing workforces in these two different cultures is obviously a critical and difficult issue and a manager that they interviewed supported this view:

“Those under 30 have never worked under and have no negative experience of the old system. They have never had a position in the Communist Party, are not afraid of censorship, and so on. Those over 40 worked prior to perestroika in research institutes, and so on, and have completely different experiences and knowledge. They have had to relearn, and none enjoy high positions.”¹⁰⁰

⁹⁹ C. Fey, C. Nordahl and H. Zatterstrom, *Organizational Culture in Russia: The Secret to Success: Developing an Understanding of What Makes a Foreign Firm’s Organizational Culture Effective in Russia* (1998).

¹⁰⁰ *Id.* at 7.

Fey et al. suggested that the problem confronting Russian managers is that these two groups have very different expectations and concepts of the culture of the company and the context in which it operates.¹⁰¹ Young Russians are energetic, excited about the future, and eager to learn. They are discovering how to survive in a market economy moving at a tremendous speed. Their elders, having been molded in the Soviet era, see their job as simply a part of the daily routine. They have little concept of market forces, and often do not possess many of the skills necessary today. Nor do they understand the make-up of a modern company. For example, Fey et al. observed that older works in Russia are “used to producing according to preset quotas and thus cannot see the *raison d’être* of sales and marketing departments”.¹⁰²

Fay et al. provided a case study of what they referred to as the “two-workforce dilemma” that focused on the situation that followed the decision by Alfa Laval, a large Swedish corporation, to acquire an older Russian state firm Potok in order to form and operate Alfa Laval Potok (ALP) to engage in the production and sale of heat exchange equipment.¹⁰³ According to Fay et al. many of the ALP workers involved in production were veterans of the original state-owned enterprise while those hired to engage in sales activities were either from the Swedish parent or younger Russians since Potok did not need a modern sales department in order to operate in the controlled economy that existed during the Soviet period. A quote from ALP’s managing director Bengt Celsing explained the challenges that confronted the “hybrid firm”:

“In order to develop Potok, a modern marketing and sales unit was needed. This we found in Alfa Laval AU, a modern marketing and sales group that Alfa Laval had previously established in central Moscow... So we moved sales to the Potok factory. We then discovered a cultural problem between the two groups, the one representing the more traditional Russian style and type of operation and the other with more modern values. Most sales and marketing employees were younger, better educated, and better paid [than those in production]. However, over time, with significant work on our part, employees have come to appreciate the importance of all the different roles they have at Alfa Laval, and the necessity of having all those different roles for the firm to be successful... We have come a long way in creating a one-company spirit.”¹⁰⁴

Fay et al. discussed the problems that managers of a firm such as ALP faced in developing an effective organizational culture given that the two Russian workforces were, in a sense, products of two different cultures and thus were not motivated by the same factors. The answer, according to Fay et al., was to create and maintain two parallel human resource organizations: for the younger and more modern Russian working primarily in the sales area there was a need to create profit sharing programs and opportunities for professional growth and interaction with other parts of the global network overseen by the Swedish parent; however, for older workers the focus needed to

¹⁰¹ Id.

¹⁰² Id.

¹⁰³ Id.

¹⁰⁴ Id. at 7-8.

be on recreating the stable environment they were used to while working at Potok. Pursuing two different paths is probably relatively easy while the older employees worked in production and the younger employees worked in sales; however, eventually the organizational culture needs to be shaped in ways that will unify both groups. For example, over time older employees might be introduced to profit sharing programs since increasing productivity within the factories is essential for the long-term performance and success of the entire enterprise.¹⁰⁵

Another interesting perspective on Russian organizational culture was provided by Herman Miller, an American manufacturer of office furniture, as part of a description of research on culture and work styles in the “BRIC” countries released in 2010. The report noted that while changes in the political environment in Russia have facilitated the emergence of a new class of business leaders with authority to make decisions on their own, rather than awaiting direction from the central government, individualism is still a new concept and the traditional sense of collectivity remains a strong influence. The Miller report noted that: “Russian business is still largely hierarchical; senior management often makes important business decisions large and small without the involvement of staff. While many senior managers may not like to give up responsibility, many subordinates fear taking it.” The high power distance associated with Russian societal culture can be seen in workplaces where managers prefer to have their own private and separate spaces to demonstrate power and authority (i.e., status consciousness). Workplaces are far from sterile, however, and the Miller report documented the preference of many employees for taking steps to make their work spaces “more homey and cheerful with decorative touches and personal artifacts”.

§1:11 Strategic planning

Fey et al. suggested that strategic planning processes in Russia might well be influenced by the practices used by the firms under the Soviet system, which they described as being long on proclaimed strategies and goals but lacking in terms of explaining the rationale behind the goals to workers when orders were passed down to management and then to the workers through the Communist party.¹⁰⁶ According to Fey et al. this approach of telling workers what their goals would be but not telling them why the goals were chosen led to a failure among workers to internalize the goals due, at least in part, to their inability to understand the entire picture and the role they were expected to play. Fey et al. went on to report, however, that they had found signs that Russian companies operating in the post-Soviet era were taking a different approach and placing greater emphasis on explaining their overall strategies to their employees so that they had a better understanding of why they were being their specific individual goals and tasks. Among the explanatory strategies deployed by Russian companies were regularly scheduled company-wide meeting during which top management discussed the future and direction

¹⁰⁵ Id. at 8.

¹⁰⁶ The discussion in this paragraph is adapted from C. Fey, C. Nordahl and H. Zatterstrom, “Organizational Culture in Russia: The Secret to Success”, *Business Horizons*, 54 (November-December 1999).

of the company and orientation programs during which new hires were provided with information on company strategies and operational practices.

Groznaya argued that contemporary Russian business culture is actually a combination of a variety of cultures grounded in a number of complex and sometimes conflicting historical, political and socio-cultural factors including Russia's unique geographic position and environment that brings unpredictable and often severe climatic conditions; a collectivist and fatalistic cultural mentality; the Orthodox Christian ethic that emphasizes obedience and strict hierarchy; and the rapid historical and political changes during the last two centuries that destroyed the society of the czars and brought both communist and post-communist institutions and mentalities.¹⁰⁷ Groznaya identified and describe three business cultures with elements still operating in Russia including the "Russian technocrat", a group which remains important even in the post-communist period and which represents the "classical Soviet set of values" and embraces formality and bureaucracy; the "first Russian entrepreneurs", a group described as "inventive, flexible and risk-taking"; and the "modern Russians" from the post-Perestroika generation who are characterized by high levels of formal business-orientation and an enthusiasm for Western work and management styles. Groznaya concluded, however, that although three business cultures might be identified for Russia they share certain similarities relevant to strategic planning: short-term planning (i.e., monthly, quarterly or yearly) is of greater importance than long-term strategic planning, particularly in a turbulent environment in which entrepreneurs want to make their profits now rather than waiting until later since what will come later cannot be predicted or controlled; a relaxed attitude toward schedules and deadlines, which are generally flexible and situational; a vertically-oriented, hierarchical structure in which decision making is generally left to top management, typically the founder/owner, perhaps with some consultations with their peers but not with subordinates; and a "flexible" attitude toward laws and regulations.

§1:12 Governance

In April 2002, using the OECD Principles of Corporate Governance as a guide, Russia adopted a Code of Corporate Conduct, also known as the Code of Corporate Governance ("CGC"), that contained provisions relating to shareholders' meetings, the board of directors and executive bodies, major corporate transactions, disclosure of information regarding the corporation, supervision of financial and business operations of the corporation, dividends and, finally, resolution of corporate conflicts. Naoumova and Judge observed that Russia's decision to adopt the CGC was largely a response to the perceived need to "integrate into the global economic environment" and that reliance of various governance codes from other countries as a source for the CGC was due to the fact that "Russia did not have enough experience or time for experimenting with an internally-developed [corporate governance code], so she largely copied western models".¹⁰⁸ The principles included in the CGC were, as is often the case, originally put

¹⁰⁷ The discussion in this paragraph is adapted from E. Groznaya, *Conflict of Generations: Business Culture of Contemporary Russia* (2009).

¹⁰⁸ I. Naoumova and W. Judge, *The Evolution and Current State of the Corporate Governance Code in Russia*, in F. Lopez-Iturriaga (Ed.), *Codes of Good Governance Around the World* (2009), 353, 354.

forward as recommendations and thus optional; however, within a few years adherence to many parts of the CGC was made mandatory for publicly listed companies in Russia and stock exchanges were placed under an obligation to monitor issuers' compliance and comply with the CGC with respect to their own operations.¹⁰⁹

Naoumova and Judge conducted interviews with representatives of large Russian companies active in a range of industries as well as with representatives from Russia's stock exchange and financial regulators, managers of medium- and small-sized companies and other interested stakeholders (e.g., educators and a representative from the Russian Chamber of Commerce) to assess the overall progress of Russian corporate governance initiatives.¹¹⁰ Among the conclusions they reached from these interviews was that the CGC "played the role of catalyst in developing best practices in Russian corporate governance world, attracted attention of the legislators to the underdeveloped system of corporate law enforcements, increased the confidence of foreign and domestic investors in the sustainability of Russian economy [and] educated large groups of managers of open and closed joint stock companies"; however, they also noted that there was room for significant improvement "especially in the areas of better protection of minority owner rights and enhanced information disclosure".¹¹¹ In addition, they reported that interviewees had criticized Russian regulators and government officials for failing to encourage compliance with the CGC, monitor its effectiveness and enforce violations of officially adopted governance standards. Naoumova and Judge predicted that "relatively new and small entrepreneurial firms with global aspirations, and relatively old and large communally-focused firms with local ties are likely to be the pioneers of the future in terms of good corporate governance in Russia".¹¹²

§1:13 Finance

The foundations of the Russian banking system are provided in the Banking Law,¹¹³ and the Central Bank of the Russian Federation Law.¹¹⁴ Bank insolvency is regulated by the Bankruptcy Law.¹¹⁵ The Central Bank of the Russian Federation ("CBR") is responsible for regulating banking activities. Through its instructions, regulations and other acts, CBR establishes rules, standards and obligatory requirements for banks and non-banking

¹⁰⁹ Id. at 355-356. In 2004 responsibility for regulation of Russian financial markets, including oversight of the corporate governance practices of listed companies, was vested in a new federal agency known as the Federal Financial Markets Service. Id.

¹¹⁰ I. Naoumova and W. Judge, *The Evolution and Current State of the Corporate Governance Code in Russia*, in F. Lopez-Iturriaga (Ed.), *Codes of Good Governance Around the World* (2009), 353, 356.

¹¹¹ Id. at 364.

¹¹² Id. at 365. For further discussion, see W. Judge and I. Naoumova, *Corporate Governance in Russia: What Model Will It Follow?*, 12 *Corporate Governance: An International Review* 302 (2004); O. Shvyrkov, *Corporate Governance is Advancing in Russia*, in S. Borodina and O. Shvyrkov, *Investing in BRIC Countries: Evaluating Risk and Governance in Brazil, Russia, India and China* 23 (2010); and P. Bartha and J. Gillies, *Corporate Governance in Russia: Is it Really Needed?*, in C. Mallin (Ed.), *Handbook on International Corporate Governance* (2006), 71.

¹¹³ Federal Law No. 395-1 On Banks and Banking Activities, dated December 2, 1990.

¹¹⁴ Federal Law No.86-FZ On the Central Bank of the Russian Federation, dated July 10, 2002.

¹¹⁵ Federal Law No. 40-FZ On Insolvency (Bankruptcy) of Credit Organizations, dated February 25, 1999.

credit organizations throughout the Russian Federation.¹¹⁶ The CBR Law provides for the establishment of a specific body within the structure of the CBR, the National Banking Council (NBC), comprised of representatives of various executive and legislative bodies. The NBC exercises control over the CBR's board of directors, and participates in establishing the basic principles of Russian banking and financial policy.

The CBR and the government share authority over monetary policy. The CBR is responsible for circulating monetary funds and ensuring the stability of the Russian Ruble. As part of its general oversight role, the CBR establishes state registration and licensing rules, determines minimum reserve requirements, and also approves the appointment of the senior management of all credit organizations. The CBR maintains regional offices throughout the Russian Federation. Several associations of Russian banks, among which the Association of Russian Banks is the largest, are also important standard-setting bodies.

Modern Russia inherited the banking system of the Soviet Union, with a few big state banks (like Sberbank, Vneshekonombank and Vneshtorgbank). Russia has a Central Bank; however, even after more than 15 years of reforms, including steps taken to scope with the country's financial crisis in 1998, the Russian banking sector remains severely underdeveloped and is still not able to perform its economic function as a financial intermediary. Russian banks are not yet able to compete internationally. Moreover, the banking sector is dominated by state-owned banks. At the same time, differentiation of the Russian banking sector is increasing and seems to be working. State regulation of the banking sector has some deficits, but seems by and large to be adequate. Banks have been forced to adopt international standards, though at a slower pace than originally planned.¹¹⁷

The international financial crisis, which reached Russia in autumn 2008, put a heavy strain on the small Russian banking sector. But the Russian state guaranteed liquidity of the banking system and thus prevented a breakdown. In 2008 and 2009, the government spent a total of US\$31 billion (equal to slightly more than 1% of GDP in both years) to support the financial sector. About half of the money was used to recapitalize banks and other financial institutions. In addition, the government and the central bank adopted a package of further measures to increase banking liquidity, including a cut in central bank reserve requirements, and increased provision of central bank loans and budget funds (for administration) to commercial banks.¹¹⁸

As a result of state support, the 2008-2009 economic crisis did not accelerate the trend towards the reduction of the number of banks in Russia. This trend is due more to a clean-up of the banking sector, which has seen the closure of shady and tiny banks, and also to mergers and takeovers. At present, there are about 1000 banks operating in

¹¹⁶ Baker & McKenzie, Banking, Russia, http://www.bakermckenzie.com/files/Uploads/Documents/Supporting%20Your%20Business/Global%20Markets%20QRGs/DBI%20Russia/q_russia_dbguide_17banking_2009.pdf.

¹¹⁷ Bertelsmann Stiftung, BTI 2012—Russia Country Report (2012).

¹¹⁸ Bertelsmann Stiftung, BTI 2012—Russia Country Report (2012).

Russia, while the Minister of Finance claimed that he expects the consolidation of the banking sector to halve that number in the longer term. Arguably the crisis helped to improve the functioning of the Russian banking sector by making authorities realize the necessity of enhancing regulation and supervision. State banks benefited from the crisis, serving as agents for distributing crisis financing to the economy. They also received direct capital injections from the state and acquired some of the troubled private banks.

The Federal Law on the Securities Market provides a legal basis for the Russian securities market.¹¹⁹ The Federal Financial Markets Service (“FFMS”) is a Russian federal executive body that regulates Russian financial markets including securities issuance and trading and supervision of exchanges, issuers, professional market participants and their self-regulatory organizations; the Russian Federation Pension Fund; and the state management company.¹²⁰ The major social role of FFMS is to promote public understanding of the securities laws and their practical application¹²¹ and to ensure a smooth operation of the Russian financial market, enhance its efficiency and investment attractiveness, as well as transparency. The FFMS is headquartered in Moscow and has 13 regional authorities around the country. There are thirteen departments and three independent divisions within the FFMS.¹²² Its primary responsibilities are regulation and control of investments; regulation of financial market participants; regulation and surveillance of securities; financial market information, monitoring and regulation; and preliminary control, supervision and monitoring of the insurance market. The FFMS exercises strict control over activities of financial market participants. It also establishes a legal framework regulating the terms and conditions for securities issuance and trading, as well as the operations of the respective professional participants. Notably, one of the prime objectives FFMS is to implement a set of regulatory and technical measures intended to counteract insider information misuse and attempted price manipulation.¹²³

Until recently key stock markets in Russia were managed by MICEX Group (Moscow Interbank Currency Exchange) and the RTS Group (Russian Trading System). The MICEX Group embraced MICEX Closed Joint Stock Company (CJSC), MICEX Stock Exchange, National Commodity Exchange, MICEX Clearing House (clearing institution), and National Depository Center (NDC), a specialized clearing bank and regional exchanges. These institutions provided trading, settlement and clearing, as well as depository services to about 1500 Russian banks and brokerage companies—stock market participants, both in Moscow and in major financial and industrial centers of

¹¹⁹ The Russian Securities Market Infrastructure Review, www.nfa.ru/nfa2/english/veb.doc.

¹²⁰ Decree No. 314 dated March 9, 2004, On the System and Structure of Federal Executive Branch Agencies.

¹²¹ Федеральная служба по финансовым рынкам, *Территориальные органы ФСФР России* (The Federal Service for Financial Markets, Territorial authorities FFMS of Russia).

¹²² Федеральная служба по финансовым рынкам, *Структура ФСФР России* (The Federal Service for Financial Markets, The structure of the Russian Federal Financial Markets Service).

¹²³ Notice should be taken of the roles of a number of self-regulating organizations seeking to bring together professional market participants and work out uniform standards for their members’ activities. PARTAD is the Professional Association of Registrars, Transfer Agents and Depositories. National Securities Association (“NFA”) unites banks and professional participants on the securities market, and National Association of Stock Market Participants (“NAUFOR”) includes non-banking professional participants on the securities market.

Russia. By overall trading volume, MICEX became the largest exchange in Russia and Eastern Europe. The RTS, established in early nineties, ranked second in terms of trading volumes. The list of securities traded on the RTS was much more comprehensive than that of MICEX, however, its trading volume was smaller. The depositary engaged in record keeping and effecting settlements under the securities traded on the RTS is a Depositary Clearing Company. In 2011 MICEX merged with RTS creating the Moscow Exchange. Professional market participants, through the use of safekeeping accounts with custodial depositaries, effect trading in securities in the over the counter (OTC) market. Among major Russian custodian depositaries are Vnesheconombank, VTB, Rosbank and some other banking depositaries.

Securities to be quoted must comply with certain requirements and conditions, such as registered prospectus of securities issuances has been registered; report on overall securities issuance results has been registered; and the issuer keeps all legislative directions on the security market. Securities can be listed on the A, B, T, V or I Quoted List as long as preconditions are met. For example, for Quoted List A, the requirements are: three-year term of a company's existence; issuer has not occurred losses during two out of three last annual tax periods; capitalized value of ordinary shares exceeds 10 billion Rubles or the capitalized value of preference shares exceeds 3 billion Rubles; and the monthly value of transactions on such securities exceed 25 million Rubles during the last three months. The requirements for Quoted Lists "B" and "V" are less strict respectively. Quoted List I includes only stocks. Normally, special professional organizations will guide the company and will ensure compliance with the legal regulations.

For certain levels of investment, venture capitalists provide a common source of equity funding in Russia.¹²⁴ The amount of money available through this source can be significant but success in securing such funding may not be easy in Russia. As in the West, venture capitalists demand a rapid and relatively high return on their investments and require evidence of a sound management track record and a clear exit plan. In return, they may provide not only financial support but also valuable relevant experience. Usually, they are also part of the board of directors.

§1:14 Human resources management

The population of Russia as of July 2012 was 142,517,670, which ranked the 9th largest in the world. Russia is very urbanized, with 73% of total population in 2010 living in urban areas. A long-term population decline of 600,000 per year is forecast, reducing the population to as little as 112 million by 2050.¹²⁵ Russia's labor force generally is considered well-educated and skilled, although its strengths increasingly are mismatched to the needs of the national economy. In 2004 the government estimated that the number of individuals of working age, 89 million in 2002, would decrease by some 10 million by

¹²⁴ PKF, Doing Business in Russia 27-31 (2011), <http://www.pkf.com/media/614183/doing%20business%20in%20russia.pdf> ss

¹²⁵ Russia, The World FactBook, US Central Intelligence Agency, <https://www.cia.gov/library/publications/the-world-factbook/geos/rs.html>.

2016. In 2012 Russia's active labor force was estimated at 75.24 million individuals, which was 8th largest in the world. Because the indigenous labor force is shrinking by as much as 1 million workers per year, the government considers long-term expansion of the immigrant labor force necessary to sustain economic growth.¹²⁶

Employment in Russia is primarily regulated by the Labor Code¹²⁷ and more specific provisions are detailed in different federal laws including the law on trade unions, their rights and guarantees of activity, the law on obligatory pension insurance in the Russian Federation and the law on basis of obligatory social insurance. In general, employees do not have a say in the management of their companies unless they are appointed members of a management committee or a director general. In some cases pertaining to labor issues the management must take the trade union's opinion into account (e.g., in cases of employees' dismissal on the decision of the employer or if prescribed by local law).

Denisova-Schmidt relied on interviews with HR managers of Russian subsidiaries of foreign companies conducted in 2006 and 2008 and an extensive review of relevant literature and research to identify certain best practices for the recruitment, selection and retention of employees used by foreign companies in Russia.¹²⁸ Denisova-Schmidt began by noting that foreign companies operating in Russia generally had to overcome two main challenges in the HRM area. First, it must be recognized that “[t]here are two different workforces in Russia: one with previous professional experience in the Soviet Union (or in modern large Russian corporations that retain elements of Soviet corporate culture) and one without . . . [and] [b]oth groups have different expectations from their employers and a different understanding of the work assignment, the motivation to work and retention factors.”¹²⁹ Second, “Western HR practices could be transferred to Russian subsidiaries, but they should be adapted to suit Russian labour regulations and cultural norms . . . [and] . . . [t]he main challenge is to find out what should be adapted, and how, in order to operate successfully.”¹³⁰ Denisova-Schmidt also cautioned that great patience would be needed to implement even the most basic HRM system in Russia and attempts to introduce new and innovative HRM techniques will often flounder, particularly in companies with a large proportion of older employees used to the HR practices employed which Russia was a planned economy.¹³¹

In Russia, companies use various recruitment tools, including internal recruitment, recruiting agencies and head-hunters, internet job engines, newspapers ads, contacts or

¹²⁶ Russia, Country Studies, Library of Congress, <http://lcweb2.loc.gov/frd/cs/rutoc.html>.

¹²⁷ Doing Business in Russian Federation, Practical Law Company, <http://us.practicallaw.com/9-517-9366?q=russian+federation#a604038>.

¹²⁸ E. Denisova-Schmidt, “The Transfer of Western Human Resource Practices to Russian Subsidiaries”, in WU Online Papers in International Business Communication Series 1: Intercultural Communication and Language Learning, Paper 2, May 2011, <http://epub.wu-wien.ac.at/>.

¹²⁹ Id.

¹³⁰ Id.

¹³¹ Id. Denisova-Schmidt explained some of the key aspects of HRM during the late Soviet era and noted that Soviet firms provided their employees with stable salaries and good social benefits and encouraged and promoted company loyalty and “team spirit”, that jobs were created to ensure full employment and that an ineffective Russian labor market undermined labor mobility. As a result, Soviet companies did not experience high employee turnover and there was no need for retention strategies. Id. at 3-5.

networking and college graduate recruitment, and the choice of which method to use depends on several factors including the type of vacancy, the internal recruitment policies and procedures of a particular company and the location of that company.¹³² Fey et al. observed that many Russian companies keep track of Russians who have elected to study abroad, since they are considered to be attractive potential recruits once they finish their studies¹³³; however, Miasoedor cautioned that Russians returning home as “re-emigrants” after a long time away will like need to overcome significant obstacles in order to gain acceptance back into Russian society and may find that the business techniques they learned and used in the West may not be easily applied in Russia and may need to be adapted in order to conform to local labor regulations and customs.¹³⁴

Denisova-Schmidt noted that Russian companies rely heavily on interviews during their recruitment and selection processes and that commented that “[while] [t]ranscripts and diplomas are also normally looked at . . . they are less important than the perception of the person as ambitious, hard-working and beneficial to the company because of his or her previous professional experience”.¹³⁵ While resumes are also requested during the recruiting process their value is questionable “since resumes have not traditionally been used in Russia, they are still poorly done and provide varying amounts of information about the candidate.”¹³⁶ Denisova-Schmidt provided a list of problems with Russian resumes that included misrepresentations in language proficiency, computer literacy, and previous employment dates.¹³⁷ Companies generally make some attempt to investigate representations in resumes regarding the duties and responsibilities of applicants at their previous employers and references are also accepted and may be checked using reference check services.¹³⁸ Denisova-Schmidt concluded that Russian HR managers had difficulties in promulgating and applying a formal set of recruiting criteria because they “usually rely on their gut feeling during the hiring process”.¹³⁹

¹³² Id. See also S. Frank, *Erfolgreiche Personalarbeit im Land des Bären*, in *Business Guide Deutschland Russland* Berlin, Wegweiser Media & Conferences, 5th ed., 2007, 114-115; S. Frank, “Personalrekrutierung in Russland”, in S. Frank and R. Wedde (Eds.), *Investmentguide Russland*, Personal, Recht, Steuern und Kommunikation in der Praxis 143 (2007).

¹³³ C. Fey, P. Engström, I. Björkman, “Doing Business in Russia: Effective Human Resource Management Practices for Foreign Firms in Russia”, *Organizational Dynamics*, 28(2) (1999), 69, 73.

¹³⁴ E. Denisova-Schmidt, *The Transfer of Western Human Resource Practices to Russian Subsidiaries* 5-6, in *WU Online Papers in International Business Communication Series 1: Intercultural Communication and Language Learning*, Paper 2, May 2011, <http://epub.wu-wien.ac.at/> (citing S. Miasoedov, *Osnovy krosskul'turnogo menedzhmenta: kak vesti bizness spredstavitel'jami drugich stran i kul'tur* 79-81 (2003)).

¹³⁵ Id. (citing C. Fey, P. Engström and I. Björkman, “Doing Business in Russia: Effective Human Resource Management Practices for Foreign Firms in Russia”, *Organizational Dynamics*, 28(2) (1999), 69, 73.

¹³⁶ Id.

¹³⁷ E. Denisova-Schmidt, *The Transfer of Western Human Resource Practices to Russian Subsidiaries* 6, in *WU Online Papers in International Business Communication Series 1: Intercultural Communication and Language Learning*, Paper 2, May 2011, <http://epub.wu-wien.ac.at/>.

¹³⁸ Id. Denisova-Schmidt noted that verification of prior employment in Russia is often problematic since there is no mature system of providing working certificates and Russian law prohibits companies from consulting with previous employers without the written consent of the candidate. As a result, it is difficult for companies in Russia to gather extensive information with respect to applicants regarding duties and other aspects of their prior employment.

¹³⁹ Id. (citing C. Fey, P. Engström and I. Björkman, “Doing Business in Russia: Effective Human Resource Management Practices for Foreign Firms in Russia”, *Organizational Dynamics*, 28(2) (1999), 69, 73; I.

Denisova-Schmidt commented that Russian companies use different tools and strategies as part of their efforts to retain employees and that the methods vary depending on industry, vacancies, age and other factors.¹⁴⁰ Denisova-Schmidt compiled an extensive list of the most important factors in retaining employees among Russian companies based on interviews and a broad survey of the literature that included good working conditions such as enough space, security, parking, access to cafeteria, etc.; professional and personal development including training and further education; Open and accessible information dissemination concerning the aims, goals, strategy and (possible) changes in an organization; internal rotation and promotion based on performance, knowledge and career growth; opportunities to take initiative, realizing that bottom-up initiative has not been traditionally welcomed or accepted in Russia; acceptance of professional mistakes and maintenance of privacy when critical feedback is given; and good salaries and competitive social benefits.¹⁴¹

Denisova-Schmidt reported that agencies are typically used to handle determination of salaries and benefits for employees at Russian companies and noted that agencies may either rely on surveys for various positions in specific industries in a particular region (e.g., consumer goods firms operating in Moscow) or on surveys and analyses referred to as “job grading” which focus on skills, job scope and duties.¹⁴² Regardless of the method that is selected problems arise due to the difficulties in obtaining up-to-date information relating to current levels of salary and benefits.¹⁴³ Denisova-Schmidt also noted that the long-standing practice of paying both official and unofficial salaries still persists within

Gurkov, “Innovations and Legacies in Russian Human Resource Management Practices: Surveys of 700 Chief Executive Officers”, *Post-Communist Economies*, 14(1) (2002), 137; and E. Denisova-Schmidt, *Internationale Unternehmen in Russland: Kampf gegen hohe Fluktuation*, in *Persorama*, 2 *Das Magazin der Schweizerischen Gesellschaft für Human Resources Management* 20 (2008)).

¹⁴⁰ E. Denisova-Schmidt, *The Transfer of Western Human Resource Practices to Russian Subsidiaries* 6, in *WU Online Papers in International Business Communication Series 1: Intercultural Communication and Language Learning*, Paper 2, May 2011, <http://epub.wu-wien.ac.at/>.

¹⁴¹ Id. (citing E. Denisova-Schmidt, “Internationale Unternehmen in Russland: Kampf gegen hohe Fluktuation”, in *Persorama*, 2 *Das Magazin der Schweizerischen Gesellschaft für Human Resources Management* 20 (2008).; C. Fey, P. Engström and I. Björkman, “Doing Business in Russia: Effective Human Resource Management Practices for Foreign Firms in Russia”, *Organizational Dynamics*, 28(2) (1999) 69, 73; C. Fey, “Overcoming a leader's greatest challenge: Involving employees in firms in Russia”, *Organizational Dynamics*, 37(3) (2008) 254; S. Frank, “Erfolgreiche Personalarbeit im Land des Bären”, in *Business Guide Deutschland Russland*, Berlin, Wegweiser Media & Conferences, 5th ed. (2007), 114-115; S. Frank, “Personal Management in Russland”, in S. Frank and R. Wedde, (Eds.), *Investmentguide Russland. Personal, Recht, Steuern und Kommunikation in der Praxis*, Stuttgart: Schäffer-Poeschel (2009), 215; S. Frank, “Personalrekrutierung in Russland”, in S. Frank and R. Wedde, (Eds.), *Investmentguide Russland. Personal, Recht, Steuern und Kommunikation in der Praxis*, Stuttgart: Schäffer-Poeschel (2009), 143; M. Magura, *Poisk i otbor personala*, Moscow, *Zhurnal Upravlenie personalom* (2003); S. Mordovin, *Upravlenie personalom, sovremennaja rossijskaja praktika* (2005); R. Scherl, “Abenteuer Personalsuche in Russland”, in *Business Guide Deutschland Russland*. Berlin: Wegweiser Media & Conferences, 6th ed. (2008), 152-153.

¹⁴² E. Denisova-Schmidt, *The Transfer of Western Human Resource Practices to Russian Subsidiaries* 8, in *WU Online Papers in International Business Communication Series 1: Intercultural Communication and Language Learning*, Paper 2, May 2011, <http://epub.wu-wien.ac.at/>.

¹⁴³ S. Frank, “Personalrekrutierung in Russland”, in S. Frank and R. Wedde (eds.), *Investmentguide Russland, Personal, Recht, Steuern und Kommunikation in der Praxis* (2007), 143.

some Russian companies and that unofficial payments are typically used to reduce social taxation and provide additional options for non-authorized work on holidays, vacations and overtime hours.¹⁴⁴

§1:15 Product development and commercialization

Writing in 2006 Kyrki and Kortelainen argued that “[a]s a country, Russia has a lot of potential for product development” and noted that even though Russia was generally a poor country, natural resources aside, after it emerged from the Cold War it nonetheless had a technology potential that was disproportionately well-endowed due to the large investments in innovative activities that had been made during the socialist period, particularly in an educational system strongly tilted toward natural and technical sciences, that had enabled the Soviet Union to achieve excellent achievements in several scientific areas.¹⁴⁵ Kyrki and Kortelainen specifically mentioned optical and mathematical processing, aviation, space, atomic energy, biology, pharmacy and nanotechnology as areas where Russian firms could presumably be able to identify and develop new product ideas as the country’s market-based economy evolved.¹⁴⁶ Unfortunately, however, the Russian innovation system has struggled since the collapse of communism for a variety of reasons. For example, investments in research and development (“R&D”) activities declined significantly in Russia during the 1990s, although the level of innovative activities did begin to improve during the early 2000s.¹⁴⁷ In addition, while post-Cold War Russian education continued to focus on technology and science, with a high percentage of students specializing in those areas, Kyrki and Kortelainen noted that ‘high intellectual potential is often combined with minor experience in business and serious lack of marketing skills’.¹⁴⁸

¹⁴⁴ E. Denisova-Schmidt, *The Transfer of Western Human Resource Practices to Russian Subsidiaries* 8, in WU Online Papers in International Business Communication Series 1: Intercultural Communication and Language Learning, Paper 2, May 2011, <http://epub.wu-wien.ac.at/>. Denisova-Schmidt explained that “Russian enterprises have long traditions of keeping two sets of books: one with actual results for internal usage and one with desired results for external audits and/or reports to the old Soviet ministries.” Id. (citing V. Suutari, “Leadership Behaviour in Eastern Europe: Finnish expatriates’ experiences in Russia and Estonia”, *International Journal of Human Resource Management*, 9(2) (1998), 235).

¹⁴⁵ A. Kyrki and S. Kortelainen, *The Key Success Factors in Distributed Product Development—Case Russia*, *Frontiers of E-Business Research* 2006, <http://iceb.nccu.edu.tw/proceedings/2006/defevent/papers/cr1053.pdf> (citing J. Hagedoorn and J. Sedaitis, “Partnerships in Transition Economies: International Strategic Technology Alliances in Russia”, *Research Policy*, 27(2) (1998), 177; I. Dezhina and L. Graham, “Russia Taking First Steps Toward Commercial Culture for Technology”, *Research Technology Management*, 44(2) (2001), 6; and M. Cervantes and D. Malkin, “Russia’s Innovation Gap”, *OECD Observer*, 229 (November 2001), 10).

¹⁴⁶ A. Kyrki and S. Kortelainen, *The Key Success Factors in Distributed Product Development—Case Russia*, *Frontiers of E-Business Research* 2006, <http://iceb.nccu.edu.tw/proceedings/2006/defevent/papers/cr1053.pdf> (citing H. Yashiro, “Knowledge Identification, Utilization and Transfer in Offshore R&D: The Case of Russia and Japan”, *Proceedings of Engineering Management Conference, IEEE International*, 2 (2005), 725).

¹⁴⁷ Ministry of Education and Science of Russian Federation, *Стратегия Российской Федерации в области развития науки и инноваций на период до 2010 г.* (Strategy for development of science and innovations till 2010) (2005); and S. Boltramovich, P. Filippov and H. Hernesniemi, *Innovation System and Business Environment of Northwest Russia*, 953 Discussion Paper, ETLA (2004).

¹⁴⁸ A. Kyrki and S. Kortelainen, *The Key Success Factors in Distributed Product Development—Case Russia*, *Frontiers of E-Business Research* 2006,

Kyrki and Kortelainen expressed particular concerns about what they characterized as “an imbalance in the innovation environment, especially relations among the main actors: R&D institutions, universities and enterprises”.¹⁴⁹ They explained that during the Soviet period each of these actors had distinct and well-defined responsibilities: “Universities were responsible for basic education. Research and product development were mostly conducted in large research institutes in a highly centralized manner. The state provided the main share of financing.”¹⁵⁰ Kyrki and Kortelainen noted that “fundamental research and applied development were commonly conducted in isolation from each other” and that, not surprisingly, emphasis was placed on either basic research or applied research primarily for military purposes and little, if any, interest was shown in market applications of research output.¹⁵¹ All of this changed, however, with the collapse of the communist regime that “scattered the pieces of the puzzle and forced the players to regroup in order to find new sources of financing”¹⁵² and also created an array of new challenges for launching an effective program of commercial-based R&D. For example, state financing for R&D activities declined substantially since the end of the Cold War, a development that created concerns about the potential adverse impact of continuing large-scale neglect of basic R&D projects. Universities and research institutes, lacking the historical guidance from the state, scrambled to figure out how to improve self-financing and shift their focus to applied research and commercialization activities.¹⁵³ Linkages between the private sector and universities performing public R&D were fragile and complicated by governmental insistence on retention of intellectual property rights associated with technology and products developed using public funds.¹⁵⁴

Kyrki and Kortelainen noted that while the Soviet economy was generally dominated by a small number of large enterprises the transition to a market-based economy has been accompanied by the growing importance of small- and medium-sized enterprises (“SMEs”), including a large number of entrepreneurial firms established by former

<http://iceb.nccu.edu.tw/proceedings/2006/defevent/papers/cr1053.pdf> (citing H. Yashiro, “Knowledge Identification, Utilization and Transfer in Offshore R&D: The Case of Russia and Japan”, Proceedings of Engineering Management Conference, IEEE International, 2 (2005), 725; and Russoft, IT Outsourcing Destination: Russia, Whitepaper, November 2005, <http://w3.russoft.ru/whitepaper/whitepaper2-rev.0.6-secured-EU.pdf>).

¹⁴⁹ A. Kyrki and S. Kortelainen, The Key Success Factors in Distributed Product Development—Case Russia, *Frontiers of E-Business Research* 2006, <http://iceb.nccu.edu.tw/proceedings/2006/defevent/papers/cr1053.pdf>.

¹⁵⁰ Id.

¹⁵¹ Id. (citing S. Boltramovich, P. Filippov and H. Hernesniemi, *Innovation System and Business Environment of Northwest Russia*, 953 Discussion Paper, ETLA, 2004).

¹⁵² A. Kyrki and S. Kortelainen, The Key Success Factors in Distributed Product Development—Case Russia, *Frontiers of E-Business Research* 2006, <http://iceb.nccu.edu.tw/proceedings/2006/defevent/papers/cr1053.pdf>.

¹⁵³ Finpro, *Innovation Centre in Russia*, Research Report, March 2006, unpublished.

¹⁵⁴ A. Kyrki and S. Kortelainen, The Key Success Factors in Distributed Product Development—Case Russia, *Frontiers of E-Business Research* 2006, <http://iceb.nccu.edu.tw/proceedings/2006/defevent/papers/cr1053.pdf> (citing OECD, *Seminar on Innovation Policy and the Valorisation of Science and Technology in Russia* (2001); and S. Boltramovich, P. Filippov and H. Hernesniemi, *Innovation System and Business Environment of Northwest Russia*, 953 Discussion Paper, ETLA (2004)).

personnel of the state research laboratories.¹⁵⁵ Unfortunately, these companies have encountered several difficult barriers to progress including a lack of retained earnings, lack of state support in form of tax and social payment discounts, lack of subsidized credits and high interest rates of bank credits.¹⁵⁶ At the same time, according to Kyrki and Kortelainen, innovative Russian SMEs have “face[d] limited domestic demand because there is little interest in new technology beyond what could be used in traditional manufacturing and natural resource industries” and, since these sectors account for two-thirds of Russian industrial investment in R&D, “innovative firms in other sectors must rely on export markets to generate sufficient demand for their products”.¹⁵⁷ Kyrki and Kortelainen also commented that large Russian companies remain reluctant to get involved with modernization of equipment or technology development and “tend to dislike long-term, science-intensive and innovative projects”; however, increased demand for innovation may be expected in the future as the economy continues to grow and competition stiffens.¹⁵⁸

The Russian government and business community have long been aware of the impediments to innovation and the need to take steps to remedy the problems described above. Announced governmental strategies for development of science and innovation in Russia have focused on financing new scientific development; development of infrastructure for innovation and R&D commercialization, including infrastructure in science and information business; internationalization of innovation; and implementation of effective intellectual property rights.¹⁵⁹ Some of the specific initiatives designed to accelerate innovative activities in Russia have included the establishment of technology parks, incubators and innovation centers.¹⁶⁰

¹⁵⁵ A. Kyrki and S. Kortelainen, *The Key Success Factors in Distributed Product Development—Case Russia*, *Frontiers of E-Business Research* 2006, <http://iceb.nccu.edu.tw/proceedings/2006/defevent/papers/cr1053.pdf> (citing K. Liuhto, “Ex-Soviet Enterprises and Their Managers Facing the Challenges of the 21st Century”, *Lappeenranta University of Technology, Studies in Industrial Engineering and Management*, 12 (2001)).

¹⁵⁶ A. Kyrki and S. Kortelainen, *The Key Success Factors in Distributed Product Development—Case Russia*, *Frontiers of E-Business Research* 2006, <http://iceb.nccu.edu.tw/proceedings/2006/defevent/papers/cr1053.pdf> (citing Finpro, *Innovation Centre in Russia*, Research Report, March 2006, unpublished).

¹⁵⁷ OECD, *Seminar on Innovation Policy and the Valorisation of Science and Technology in Russia* (2001).

¹⁵⁸ A. Kyrki and S. Kortelainen, *The Key Success Factors in Distributed Product Development—Case Russia*, *Frontiers of E-Business Research* 2006, <http://iceb.nccu.edu.tw/proceedings/2006/defevent/papers/cr1053.pdf> (citing M. V. Šehovcev, “Венчурные фонды, крупные корпорации и малые инновационные предприятия (venture funds, large corporations and small innovative firms)” *ЭКО*, no. 2 58 (2006)).

¹⁵⁹ A. Kyrki and S. Kortelainen, *The Key Success Factors in Distributed Product Development—Case Russia*, *Frontiers of E-Business Research* 2006, <http://iceb.nccu.edu.tw/proceedings/2006/defevent/papers/cr1053.pdf> (citing Ministry of Education and Science of Russian Federation, *Стратегия Российской Федерации в области развития науки и инноваций на период до 2010 г. (Strategy for development of science and innovations till 2010)* (2005); and Finpro, *Innovation Centre in Russia*, Research Report, March 2006, unpublished).

¹⁶⁰ A. Kyrki and S. Kortelainen, *The Key Success Factors in Distributed Product Development—Case Russia*, *Frontiers of E-Business Research* 2006, <http://iceb.nccu.edu.tw/proceedings/2006/defevent/papers/cr1053.pdf> (citing N. Berzon, “Формирование инвестиционного климата в экономике (Formation of investment climate in economy)” *Вопросы экономики (Economic questions)*, Issue 7 104 (2001)).

A survey of 100 large companies operating in Russia conducted in May 2010 by PricewaterhouseCoopers, the New Economic School, the Russian Venture Company and the Russian Corporation of Nanotechnologies provided evidence that the largest ones, especially those companies—both Russian and foreign—active in global markets, are the most prolific innovators in terms of launching new products and implementing new technologies and business processes.¹⁶¹ While a significant amount of the innovative activity was focused on products, technologies and processes that were “new to global markets” most of the time and effort among the respondents was concentrated on innovation that was “new to the company” (i.e., implementing and adapting existing innovative products, technologies and processes as a means for rapidly improving internal efficiencies in order to become and remain more competitive). Active innovation was more likely among large private companies operating inside and outside of Russia than among companies that remained fully or partially owned by the government and the level and intensity of innovation was positively correlated to the degree of globalization (i.e., international companies operating in Russia were more active innovators than Russian companies and Russian companies engaged in global markets were more innovative than Russian companies that limited their activities to the domestic market). Most of the actively innovative companies relied on internal development, as opposed to seeking assistance from external Russian and foreign contractors, and development projects were typically funded with the company’s own capital. Financing new product development initiatives, as well as bureaucratic restrictions, were the most commonly mentioned impediments to innovation and respondents commented that the state could assist innovation by making improvements to higher education, increasing state financing for R&D and providing tax incentives for innovative activities.

§1:16 Technology management

R&D has been declared a top priority of the Russian government and received the personal attention of Presidents Dmitry Medvedev and Vladimir Putin. However, government action has so far focused on an isolated, though expensive, pet project (the creation of a Russian Silicon Valley near Moscow), which is not having a broader impact on the innovation potential of the Russian economy. Spending on R&D has hovered around 1% of gross domestic product (GDP) in recent years. Former President Dmitry Medvedev announced plans in 2010 to create Russia’s own version of Silicon Valley in Skolkovo, outside of Moscow, and won pledges from an impressive array of global technology companies including Intel, Microsoft, Siemens, Samsung and Cisco to invest in Russia’s technology sector; however, once Vladimir Putin returned to the presidency in 2012 political intrigue and rivalries have caused the project to stall.¹⁶²

Technology management in Russia, including strategies for internal development and external acquisition, remains strongly influenced by cultural and political factors. To the

¹⁶¹ The discussion in this paragraph is adapted from PricewaterhouseCoopers, *Innovation by Large Companies in Russia: Mechanisms, Barriers and Perspectives* (June 2010).

¹⁶² Kremlin Intrigue Threatens Russia’s Silicon Valley, <http://www.businessweek.com/articles/2013-07-18/kremlin-intrigue-threatens-russias-silicon-valley>

extent that internal development of new technologies depends on a willingness and ability to plan and create a collaborative environment Russian firms labor under a tendency to use short-term criteria in decision-making and business development due to the turbulence in their external environments.¹⁶³ Internal collaboration is often difficult because of the propensity of Russian entrepreneurs to zealously guard their plans and share little information with others in the organization, much less with outside partners that might be able and willing to provide support for research and development in the form of technical assistance and/or funding.¹⁶⁴

Collaborations with outside companies, such as Western firms looking to invest in the Russian marketplace, have typically been limited to sales opportunities in promising markets (e.g., in food and tobacco industries, consumer goods production and services provision) rather than technology opportunities and parties from both sides have typically been quite reluctant to work together on R&D projects.¹⁶⁵ However, some foreign companies, particularly those involved in information and communications technology, have engaged in R&D cooperative arrangements and/or opened R&D centers in Russia in order to gain access to what they perceive to be a large amount of highly educated personnel with an attractive quality-cost ratio.¹⁶⁶ Those Russian companies that have been open to working with Western partners have gained access to state-of-the-art technology and business know-how relating to quality control and other management issues, intangible assets that are especially valuable and scarce in Russia due to the lack of extensive exposure to international levels of technical and quality standards.¹⁶⁷

Russia's accession to membership in the World Trade Organization in 2012 was preceded by a long and extensive process of reforms to the country's laws and regulations pertaining to intellectual property rights including initiatives taken in order to comply with commitments made in a 2006 bilateral agreement between the US and Russia on intellectual property rights. In 2012 Russia announced that it shared the beliefs of the US that "strong IPR protection and enforcement are vital to promoting innovation and creativity by securing the rights of innovators and the creative community, attracting

¹⁶³ M. A. Hitt, D. Ahlstrom, M. T. Dacin, E. Levitas and L. Svobodina, "The Institutional Effects on Strategic Alliance Partner Selection in Transition Economies: China vs. Russia", *Organization Science*, 15(2) (2001), 173.

¹⁶⁴ G. D. Bruton and Y. Rubanik, "Resources of the Firm: Russian High-Technology Startups and Firm Growth", *Journal of Business Venturing*, 17(6) (2002), 553.

¹⁶⁵ S. Boltramovich, P. Filippov and H. Hernesniemi, *Innovation System and Business Environment of Northwest Russia* (2004); and D. A. Dyker, "Technology Exchange and the Foreign Business Sector in Russia", *Research Policy*, 30(5) (2001), 851 (also commenting that Russian scientific and industrial leaders tended to view foreign business with suspicion, whereas foreign businessmen viewed Russia as a difficult environment and a poor risk in investment terms).

¹⁶⁶ A. Dynkin and N. Ivanova, "Technological Innovation in Russia", *Journal of Product Innovation Management*, 15(5) (1998), 476; and S. Boltramovich, P. Filippov and H. Hernesniemi, *Innovation System and Business Environment of Northwest Russia* (2004).

¹⁶⁷ A. Dynkin and N. Ivanova, "Technological Innovation in Russia", *Journal of Product Innovation Management*, 15(5) (1998), 476; G. Bruton and S. Samiee, "Anatomy of a Failed High Technology Strategic Alliance", *Organizational Dynamics*, 27(1) (1998), 51; and J. Hagedoorn and J. Sedaitis, "Partnerships in Transition Economies: International Strategic Technology Alliances in Russia", *Research Policy*, 27(2) (1998), 177.

high-technology investment, and fostering the job necessary for long-term sustainable growth”; however, in spite of the formal agreements and public statements significant issues remain regarding intellectual property protection in Russia and the United States Trade Representative continued to include Russia on its Priority Watch List for 2013 and noted, in particular, that concerns continued regarding “inadequate enforcement against the growing problem of online piracy”.¹⁶⁸

Valdaytsev and Sergeyev argued that Russians are fully aware of the need for radical innovation in technology among both business and government in Russia but problems with respect to improving Russia innovation systems have festered due, in large part, to a lack of financial support.¹⁶⁹ They noted that Russian companies can no longer escape treacherous and intense foreign competition as Russia continues its path toward full integration into the world economic and trade community by opening its markets and that Russian companies need to acquire or develop new technologies that can be used to create products that fend off foreign competitors with better products and technologies. However, projects focusing on radical innovation, or even just significantly reducing the technology gap between Russian companies and their foreign competitors, require a significant amount of money and long-term patience from investors, both of which are hard to find in Russia where persistently high inflation rates drive up the demands of investors with respect to their return on investment given the risks associated with the innovation projects. Investors are also rightly concerned about technological backwardness in Russia, administrative delays with respect to approval of investments, corruption and weak enforcement of intellectual property rights. Given the high cost of equity investment to companies and the reluctance of investors to give up control of their capital in equity-based deals Russian companies turned to debt financing to support their technical re-engineering projects; however, this strategy led to financial distress, even bankruptcy, a significant amount of times. Another factor influencing the development of Russia’s innovation systems include the continued strengthen of national technical and environmental standards by the government, directives that arguably complicate the R&D issues already confronting Russian companies. Valdaytsev and Sergeyev recommended that that the Russian government pay more attention to providing direct support from the federal budget for major national-scale private innovation projects and that Russian companies should carefully manage their capital structure through benchmarking and developing capital structure optimization techniques which take into account both industry peculiarities and innovation strategy special features.

§1:17 Globalization

Russia is a member of the World Trade Organization and a party to various other bilateral trade agreements.¹⁷⁰ While, in principle, these agreements have liberalized Russia’s foreign trade the reality is that a number of significant regulatory exceptions have

¹⁶⁸ Office of the United States Trade Representative, 2013 Special 301 Report (2013), 41.

¹⁶⁹ The discussion in this paragraph is adapted from S. Valdaytsev and A. Sergeyev, *Technological Innovations in Russia* (2011).

¹⁷⁰ The discussion in this paragraph is adapted from Bertelsmann Stiftung, *BTI 2012 — Russia Country Report* (2012).

remained in place including various restrictions on certain types of imports and exports. As a result, Russia has been continuously involved in trade disputes, often with the neighboring European Union. Other problems have arisen when Russia has new protective import tariffs, as it did on some agricultural products and on cars in 2008 as part of its response to the then-current global economic crisis. While, in general, foreign companies and citizens have the same rights and obligations as Russian companies and individuals under Russian law, certain federal laws, such as the Law on Foreign Investment in Strategic Companies, restrict foreign investment activity in areas involving national security issues.¹⁷¹ Special economic zones have been established to provide incentives, generally tax preferences, for certain types of investment and Russia has famously undertaken high profile projects such as the Sochi 2014 Olympic Games as a means for garnering acceptance in the international community.

The record is clear that the Russian economy suffered immensely in the years following the collapse of the Soviet Union and that the country's principal state institutions were dramatically discredited and adrift regarding the role they should play and the future that they should pursue. Russia lost international prestige and status as the country's economy spiraled downward and standards of living for its citizens declined. In fact, the collapse was monumental, as economists estimated that "[b]etween 1992 and 1995, Russia's GDP fell 42% and industrial production fell 46%—far worse than the contraction of the US economy during the Great Depression" and that "[b]y the mid to late nineties, more than 44 million of Russia's 148 million people were living in poverty".¹⁷² As all of this was going on, other nations were taking advantage of Western-led globalization to spread their products, brands and lifestyle preferences, much of which found its way into Russia, while "Russia's own money, brand names, values, lifestyles and opinions were driven to the verge of extinction".¹⁷³

The events following the breakup of the Soviet Union hardly supported the prediction of some, both in Russia and in the West, that Russia would be able to take "a big leap forward to the radiant capitalist future".¹⁷⁴ Nonetheless, Molchanov cited several reasons why Russia's globalization will continue and increase including its location in Europe and membership in the family of European nations, a geopolitical fact that inevitably ties Russia to the European Union and its individual members; its position as a natural bridge between Europe and Asia generally and the European Union and China in particular; its possession of large and strategically-placed energy reserves which will make it a major player in the Central Asian-Caspian energy market for decades to come; and its ability to play an important role in supporting Western efforts to combat terrorism.¹⁷⁵ In fact, recent evidence points to Russia being on track to once again become a major factor in world economic affairs with significant increases in oil production and exports and by

¹⁷¹ Practical Law Company, *Doing Business in the Russian Federation*, <http://us.practicallaw.com/9-517-9366?q=russian+federation#a604038>.

¹⁷² N. Holmstrom and R. Smith, "The Necessity of Gangster Capitalism: Primitive Accumulation in Russia and China", *Monthly Review*, 51(9) (2000), 5.

¹⁷³ M. Molchanov, "Russia and Globalization", in R. Day and J. Masciulli (Eds.), *Globalization and Political Ethics* (2005), 147, 151-152.

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

2012, for example, Russia's exports of US\$2.02 trillion exceeded its imports of US\$1.78 trillion by US\$250 billion and its total trade with the European Union was close to €78 billion.¹⁷⁶

Various researchers have analyzed different aspects of internationalization among Russian companies, both inward and outward. Several have noted key reasons why Russian firms are interested in engaging with companies from developed countries including gaining access to Western brands, which are preferred by Russian customers¹⁷⁷, securing and strengthen contacts with potential Western customers¹⁷⁸, and obtaining financial supports for development of their own innovative ideas.¹⁷⁹ Russian companies seem to prefer alliance with European partners, given the short geographical distance and perceived cultural similarities. Hagedoorn and Sedaitis noted that research-intensive alliances between Russian companies and foreign partners usually take the contractual form, while manufacturing-oriented alliances usually are operated as an equity joint venture.¹⁸⁰ Karhunen and Kosonen analyzed the determinants of Western-Russian production alliances by looking at Finnish-Russian production subcontracting relationships in the metal industry and found that their success had been modest due to different perceptions of the alliance and expected contribution by the partners.¹⁸¹ Others have expressed skepticism regarding the viability of cross-border alliances based on production in Russia since the motivation for such alliances is usually lower production costs and/or gaining access to markets and the relatively high labor costs in Russia do not offer foreign partners to the same cost saving opportunities they would find in other emerging markets.¹⁸² As with other developing or emerging markets, Russia has growing group of SMEs; however, internationalization through cooperation with foreign partners by Russian SMEs has been relatively slow and the Russian companies that have been successful in those alliances have tended to be newer and thus relatively unencumbered by the extensive financial and institutional commitments, and bureaucracy and formalism, that were in place before the collapse of communism.¹⁸³

¹⁷⁶ The European Union, EU-Russia Trade (http://europa.eu.int/comm/external_relations/russia/intro/trade.htm).

¹⁷⁷ J. Hagedoorn and J. Sedaitis, "Partnerships in Transition Economies: International Strategic Technology Alliances in Russia", *Research Policy*, 27(2) (1998), 177.

¹⁷⁸ I. Dezhina and L. Graham, "Russia Taking First Steps toward Commercial Culture for Technology", *Research Technology Management*, 44(2) (2001), 6.

¹⁷⁹ Finpro, *Innovation Centre in Russia* (2006).

¹⁸⁰ J. Hagedoorn and J. Sedaitis, "Partnerships in Transition Economies: International Strategic Technology Alliances in Russia", *Research Policy*, 27(2) (1998), 177.

¹⁸¹ P. Karhunen and R. Kosonen, *Determinants of Western-Russian Production Alliances—The Case of Finnish Metal Industry SMEs' Subcontracting in Russia* (2002).

¹⁸² D. A. Dyker, "Technology Exchange and the Foreign Business Sector in Russia", *Research Policy*, 30(5) (2001), 851; H. Yashiro, *Knowledge Identification, Utilization and Transfer in Offshore R&D: The Case of Russia and Japan*, 2 Proceedings of Engineering Management Conference, IEEE International (2005), 725.

¹⁸³ Finpro, *Innovation Centre in Russia* (2006); J. Hagedoorn and J. Sedaitis, "Partnerships in Transition Economies: International Strategic Technology Alliances in Russia", *Research Policy*, 27(2) (1998), 177; and J. Sedaitis, "Waking the Sleeping Giants: Commercializing State R&D in the United States and Russia", *Technological Forecasting and Social Change*, 53(3) (1996), 293.