

Chapter 2

SMEs and Entrepreneurship in the Russian Federation

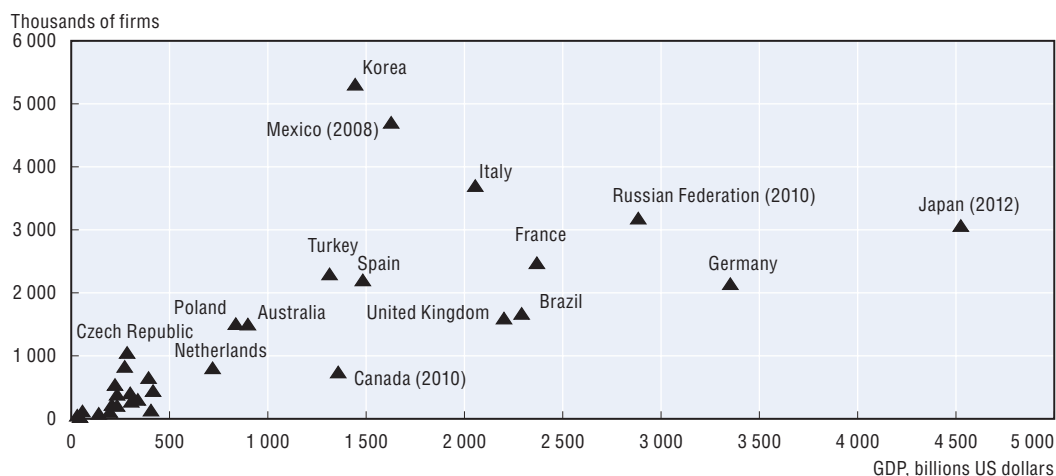
This chapter examines the state and recent evolution of entrepreneurship and SME activity in the Russian Federation. It presents key structural indicators such as the SME share in enterprises, employment and GDP, the sector and size distribution of SME activity, business start-up rates, entrepreneurial intentions, number of growth firms and the size of the informal economy. It also analyses performance indicators including productivity, exports, investment and innovation.

SME activity

Limited numbers of SMEs

The Russian Federation counted an estimated 3.2 million operating businesses, including the self-employed, in 2010. As shown in Figure 2.1, this is a small number relative to the size of the Russian economy. Several smaller economies such as Italy, Mexico and Korea have greater numbers of businesses than the Russian Federation. Table 2.1 shows these SME numbers in terms of a density of enterprises as a share of the working age population. The rate of 31 registered enterprises per 1 000 population in the Russian Federation is well below that of the OECD countries, and compares for example with rates of 67 in Mexico and 102 in the United States.

Figure 2.1. **Number of enterprises and GDP**
2011 or latest available year



Note: Figures refer to the number of operating enterprises in the business sector, excluding the agriculture and government sectors. They include registered enterprises (“legal entities”) and the self-employed (“independent entrepreneurs”). Tax records identify some additional proprietary businesses that are considered as non-operational by the national statistical office.

Source: OECD (2014) *Entrepreneurship at a Glance 2014*, Paris. http://dx.doi.org/10.1787/entrepreneur_aag-2014-en. Figures for Russian Federation from Rosstat SMEs in Russia (2011).

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In terms of size breakdown, some 79.5% of enterprises in the Russian Federation were micro firms (1-9 employees) in 2012, 16.0% were firms sized 10-49 employees, 3.8% were of 50-249 employees and 0.7% were large firms of at least 250 employees (OECD, 2014). Compared with other countries there is a particular dearth in the numbers of micro- and small-sized enterprises.

Table 2.1. Number of enterprises per working age population, 2011 or latest year

	Number of enterprises (thousands)	Working age population	Enterprises per 1000 population
Switzerland	134	5 372 242	25
New Zealand (2010)	83	2 902 000	29
Russian Federation (2010)	3 180	102 846 000	31
Ireland	110	3 066 600	36
Japan (2012)	3 064	81 493 000	38
United Kingdom	1 595	41 710 800	38
Germany	2 141	54 048 604	40
Turkey	2 295	48 226 830	48
Austria	303	5 675 483	53
Greece (2009)	405	7 449 000	54
Poland	1 503	27 438 382	55
Denmark (2010)	207	3 631 155	57
France	2 471	40 766 767	61
Estonia	55	894 643	61
Belgium	446	7 267 065	61
Finland	224	3 538 000	63
Mexico (2008)	4 706	70 679 579	67
Spain	2 199	31 225 029	70
Netherlands	804	11 135 552	72
Hungary	540	6 836 546	79
Luxembourg	29	356 164	81
Slovenia	116	1 418 366	82
Israel (2012)	383	4 664 500	82
Norway	271	3 276 000	83
Slovak Republic	346	3 881 763	89
Italy	3 702	39 811 683	93
Australia	1 502	14 846 000	101
United States (2010)	21 143	207 648 030	102
Sweden	647	6 113 639	106
Portugal	826	6 981 487	118
Czech Republic	1 049	7 295 598	144
Korea	5 305	36 352 538	146

Note: Figures refer to the number of operating enterprises in the business sector, excluding the agriculture and government sectors. They include registered enterprises and the self-employed.

Source: OECD(2014) Entrepreneurship at a Glance and OECDstat Population Statistics database. Figures for Russian Federation from Rosstat SMEs in Russia report (2011).

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Limited SME employment

In 2010, it is estimated that just over 18 million people were employed in SMEs in the business sector in the Russian Federation. At only 18% of the working population, employment in SMEs is relatively low in the Russian Federation (Table 2.2). Similarly, at less than 30%, the share of business sector employment accounted for by SMEs in the Russian Federation is much lower than in other countries, as shown in Figure 2.2. These figures suggest that there is great potential for job creation by establishing and growing an SME sector in the Russian Federation. Much of the SME employment gap is the result of a small micro enterprises sector. Thus, the proportion of business employment in small firms (defined as 1-15 employees in the Russian Federation) at 13% is smaller than that of employment in small firms (defined as 1-9 employees) in almost all OECD countries. Overall, these low shares of SME employment are common to both the manufacturing and services sectors (OECD, 2014).

Table 2.2. **SME employment as a share of the working age population, 2011 or latest year**

	SME employment	Working age population	Proportion of working age population employed in SMEs (percentage)
Turkey (2009)	4 560 654	48 226 830	9
Estonia	125 131	894 643	14
Greece (2009)	1 056 236	7 449 000	14
Ireland	462 096	3 066 600	15
Russian Federation (2012)	18 120 000	102 846 000	18
United States (2010)	38 121 694	207 648 030	18
Korea	7 000 104	36 352 538	19
Slovenia	277 981	1 418 366	20
Poland	5 416 765	27 438 382	20
Finland	708 623	3 538 000	20
United Kingdom	8 455 428	41 710 800	20
Luxembourg	74 343	356 164	21
Belgium	1 539 909	7 267 065	21
Slovak Republic	841 941	3 881 763	22
France	9 012 535	40 766 767	22
Denmark (2010)	812 018	3 631 155	22
Hungary	1 582 053	6 836 546	23
Spain	7 703 013	31 225 029	25
New Zealand (2010)	716 965	2 902 000	25
Sweden	1 626 221	6 113 639	27
Austria	1 541 784	5 675 483	27
Italy	11 186 215	39 811 683	28
Australia (2010)	4 245 495	14 846 000	29
Mexico (2008)	20 260 865	70 679 579	29
Germany	15 734 377	54 048 604	29
Netherlands	3 300 047	11 135 552	30
Norway	1 007 810	3 276 000	31
Portugal	2 166 851	6 981 487	31
Switzerland	1 737 030	5 372 242	32
Czech Republic	2 439 886	7 295 598	33
Japan (2009)	38 452 501	81 493 000	47
Israel (2009)	2 227 323	4 664 500	48

Note: Data refer to enterprises in the business economy, excluding the agriculture and government sectors.

Source: OECD (2014) Enterprise at a Glance 2014 and OECDstat Population Statistics database. Figures for Russian Federation from Rosstat (2013) SMEs in Russia 2013.

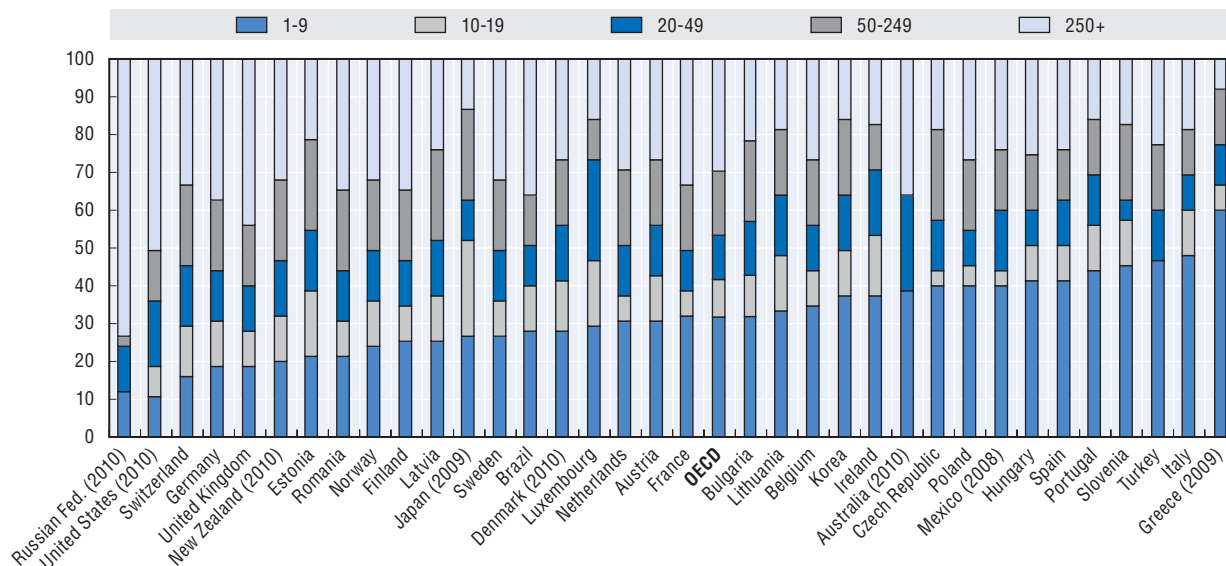
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Low SME output and investment

Table 2.3 provides information on the sales, investment and assets of Russian Federation SMEs. When expressed as a share of total business activity, SMEs accounted for 32% of enterprise sales in 2012 (Rosstat, 2013). While not strictly comparable with international data, this proportion is well below the average typical figure in OECD countries of around two-thirds of business value added generated SMEs (OECD, 2014). Furthermore, SMEs accounted for only 7.6% of the total fixed capital investments of businesses and 23.5% of the fixed assets of the total enterprise sector in 2012 (Rosstat, 2013). These figures underline the need to increase the quality of existing SME activity in the Russian Federation as well as increase the numbers of businesses and their employment.

Figure 2.2. **Share of employment by enterprise size class**

Percentage of total employment in enterprises



Note: The size-class breakdown 1-9, 10-19, 20-49, 50-249, 250+ provides for the best comparability given the varying data collection practices across countries. Some countries use different conventions: the size class “1-9” refers to “1-10” for Mexico; “1-19” for Australia and Turkey; the size class “10-19” refers to “11-50” for Mexico; the size class “20-49” refers to “20-199” for Australia and “20-99” for the United States; the size class “50-249” refers to “50-299” for Japan, “51-250” for Mexico and “100-499” for the United States; finally, the size class “250+” refers to “200+” for Australia, “300+” for Japan, “251+” for Mexico and “500+” for the United States. Figures for Russian Federation: «1-9» refers to 1-15; «20-49» refers to 16-100 «50-249» refers to 101-250.

Source: OECD (2014), Entrepreneurship at a Glance 2014, OECD Publishing, http://dx.doi.org/10.1787/entrepreneur_aag-2014-en. Figures for Russian Federation from Rosstat SMEs in Russia 2011 and Rosstat databases.

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Table 2.3. **SME output and investment, Russian Federation, 2012 or latest available year**

	All SMEs	Medium enterprises	Small enterprises	Micro enterpris
Number of businesses registered	2 016 800	13 800	243 000	1 760 000
Sales, RUB billions	28 174	4 711	15 116	8 347
Fixed capital investments, RUB billions	729	208	364	157
Fixed assets (book value), RUB billions	21 285	1 657	2 465	17 163

Note: The figures for registered enterprises include non-operational enterprises, which suspended or did not start business operations. Micro enterprises are defined as having employment of less than 15 or sales less than RUB 60 million; small enterprises have 16-100 employees or sales up to RUB 400 million; medium enterprises have employment of 101-250 or sales or not more than RUB 1 billion.

Source: Rosstat (2013) SMEs in Russia report 2013.

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Weighting to non-propulsive sectors

Table 2.4 shows that SME business numbers and employment in the Russian Federation are significantly weighted towards wholesaling and retailing. These sectors represented nearly one-half of all SMEs by number and more than one-third of SME employment. They make up particularly high shares of the numbers and employment of the smallest enterprises. A further one-third of SMEs and SME employment are in the domestic consumption oriented sectors of hotels, restaurants, transport, communications, construction, and real estate, renting and business services. On the other hand, manufacturing accounted for only 7% of

SMEs by number and only 13% by employment, including the self-employed. The proportions of manufacturing were lowest in the smallest enterprise size bands. In the “medium” size class the representation of manufacturing was nevertheless higher; manufacturing accounted for 25% of medium-sized enterprises and 29% of employment in medium-sized enterprises.

These data indicate a shortfall in the scale of the manufacturing sector within the activities of SMEs in the Russian Federation, and a bias towards consumer-oriented services. Put in other terms, less than 20% of manufacturing employment was in SMEs in the Russian Federation, compared with 38% of services employment. The SME share of employment in manufacturing tends to be much higher in comparator countries. For example, SMEs accounted for approximately 49% of manufacturing employment in the United States, 51% in Mexico, 52% in Brazil, 61% in Poland, 71% in Korea and 76% in Italy and Bulgaria (OECD, 2014).

A substantial increase should be sought in the scale of SME manufacturing activity in the Russian Federation in order to exploit its relatively good prospects to sustain long-run productivity growth, provide export income and diversify Russian exports away from natural resources exploitation, as well as to support growth in the rest of the economy through supply chain inputs. While short-term productivity improvements in the Russian Federation’s transport, construction and services sectors can make significant contributions to economic growth, these sectors tend to have a relatively low capacity to generate export income and a relative small scope for long-term productivity growth compared with manufacturing. Furthermore, while the agriculture, fisheries, mining and gas sectors can have high productivity and high productivity growth and be important exporters, they are based on natural resources exploitation, whereas the long-term growth of the Russian economy requires this to be complemented with other types of exports further up the value chain. Thus support for growth in manufacturing SMEs is a particular priority for the Russian Federation, potentially complemented with an emerging knowledge-intensive business services sector supplying producers rather than consumers.

Table 2.4. **Sector composition of SMEs and individual entrepreneurs, Russian Federation, 2012**

Share of enterprises, percentage

	By number of enterprises					By employment				
	All	Medium	Small	Micro	Individual Entrepreneur	All	Medium	Small	Micro	Individual Entrepreneur
Agriculture and fisheries	5	20	5	3	5	7	19	6	3	6
Construction	7	12	13	11	3	10	12	14	13	3
Mining, electricity and gas	0	4	2	1	0	2	5	2	1	0
Manufacturing	7	25	15	9	5	13	29	17	10	7
Wholesale and retail trade	48	23	29	41	54	36	14	23	37	58
Hotels and restaurants	2	1	4	3	2	3	1	4	4	3
Transport and communication	10	4	6	7	13	7	5	6	6	9
Real estate, renting, and business activities	15	10	21	20	11	16	10	22	21	7
Other	6	2	5	6	7	5	4	5	6	5
Total	100	100	100	100	100	100	100	100	100	100

Note: Data cover all registered enterprises including some that may not be operating. The figure for All SMEs includes both legal entities (which are further divided between medium, small, and micro) and individual entrepreneurs, with or without employees. Micro enterprises are defined as having employment of less than 15 or sales less than RUB 60 million; small enterprises have 16-100 employees or sales up to RUB 400 million; medium enterprises have employment of 101-250 or sales or not more than RUB 1 billion. Figures include legal entities but exclude individual entrepreneurs, or the self-employed.

Source: Calculated from Rosstat (2013) SMEs in Russia 2013.

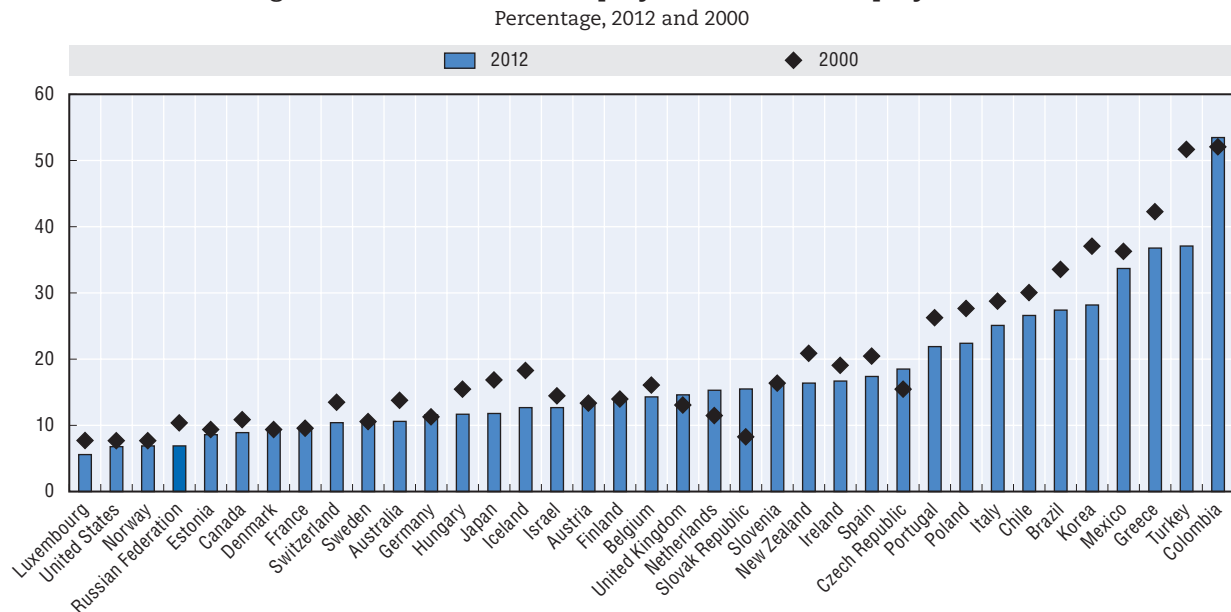
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Growth in SME manufacturing could be supported by a stronger focus in SME support programmes on measures for innovation, exporting, and investment in physical and human capital. These measures are likely to see relatively greater take-up from manufacturing firms, and particularly medium-sized manufacturers, even without any specific targets for numbers or proportions of manufacturing enterprises to be covered by such programmes or eligibility restrictions to manufacturing firms. Indeed, the option should be available for firms in other sectors (particularly knowledge intensive business services) to participate on a case-by-case basis, since some non-manufacturing enterprises could also achieve significant output, export and productivity growth as a result.

Self-employment

According to the labour force survey, there were an estimated 4.9 million employers and persons working on their own account in the Russian Federation in 2012, representing some 6.9% of all civil employment. This is a relatively low share; across OECD countries the average share of self-employment was some 17% (Figure 2.3). Furthermore, the self-employment rate declined in Russia between 2000 and 2012. More than one-half of the self-employed operated in wholesaling and retailing. Other significant sectors for self-employment were transport and communications and real estate and business services, but less than 5% of the self-employed were in manufacturing (Rosstat, 2013)

Figure 2.3. **Share of self-employment in total employment**



Note: Figures for Brazil and Columbia are for 2001 not 2000; figures for Chile France and Luxembourg are for 2011 not 2012; figures for Australia, Canada, and United States for do not include incorporated self-employed.

Source: OECD Annual Labour Force Statistics database; Employment by Activities and Status <http://dx.doi.org/10.1787/lfs-data-en>.

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Entrepreneurial activity

Business start-up

In 2014, just 2.4% of the Russian Federation population was engaged in nascent entrepreneurship, the lowest rate of any of the large efficiency-driven economies; and, at 2.4%, the rate of new business ownership in the Russian Federation was also very

low (Table 2.5). Taking the two indicators together, the total early stage entrepreneurial activity rate in the Russian Federation was the lowest of the large efficiency-driven economies. This suggests that the forward pipeline of entrepreneurs coming into activity in the Russian Federation is currently very weak. Indeed, the percentage of the population running businesses that have been established for at least 42 months is only 4.0% in the Russian Federation compared to an average of 8.5% in efficiency-driven economies as a whole.¹

The Table also distinguishes between “opportunity driven entrepreneurs”, who claim to have started their business to exploit specific business opportunities, and “necessity driven entrepreneurs”, who open businesses mainly because they have no or few other sources of income. The motives are interesting, although the distinction is generally not a good indicator of subsequent business performance. This is because an entrepreneur’s motives for running a business can change over time and changes in the external environment can affect entrepreneurial opportunities. In the Russian Federation, while 42% of entrepreneurs could be attributed to necessity reasons, 59% were more opportunity driven. This balance is very similar to the overall average for the listed countries.

Table 2.5. **Entrepreneurial activity rates in efficiency-driven economies, 2014**

	Nascent	New business ownership	Total early stage entrepreneurship	Established business ownership	Opportunity driven	Necessity driven
	Percentage of population aged 18-64 years				Percentage of early stage entrepreneurs	
Argentina	9.5	5.2	14.4	9.1	68	28
Barbados	8.5	4.2	12.7	7.1	74	15
Bosnia and Herzegovina	4.5	2.9	7.4	6.7	48	51
Brazil	3.7	13.8	17.2	17.5	71	29
Chile	16.6	11.1	26.8	8.8	81	18
China	5.5	10.2	15.5	11.6	66	33
Croatia	6.0	2.0	8.0	3.6	51	47
Hungary	5.6	3.9	9.3	8.0	65	33
Latvia (2013)	8.1	5.3	13.4	8.8	53	21
Lithuania	6.1	5.3	11.3	7.8	80	20
Malaysia	1.4	4.6	5.9	8.5	82	18
Mexico	12.7	6.4	19.0	4.5	76	22
Panama	13.1	4.1	17.1	3.4	73	26
Peru	23.1	7.3	28.8	9.2	83	16
Poland	5.8	3.6	9.2	7.3	59	37
Romania	5.3	6.2	11.4	7.6	70	29
Russian Federation	2.4	2.4	4.7	4.0	59	39
Slovak Republic	6.7	4.4	10.9	7.8	64	33
South Africa	3.9	3.2	7.0	2.7	71	28
Thailand	7.6	16.7	23.3	33.1	81	18
Trinidad and Tobago	7.5	7.4	14.6	8.5	86	12
Turkey (2013)	5.5	4.7	10.2	5.7	54	30
Uruguay	10.5	5.8	16.1	6.7	82	16

Notes: Nascent entrepreneurship is defined as the percentage of the population between 18 and 64 years that is currently involved in starting a business either as owners or co-owners. New business ownership is defined as the percentage of the population between 18 and 64 years that are currently owners, owners or managers of businesses that are less than 42 months old. Total early stage entrepreneurial activity is the sum of the nascent entrepreneurship and new business ownership rates.

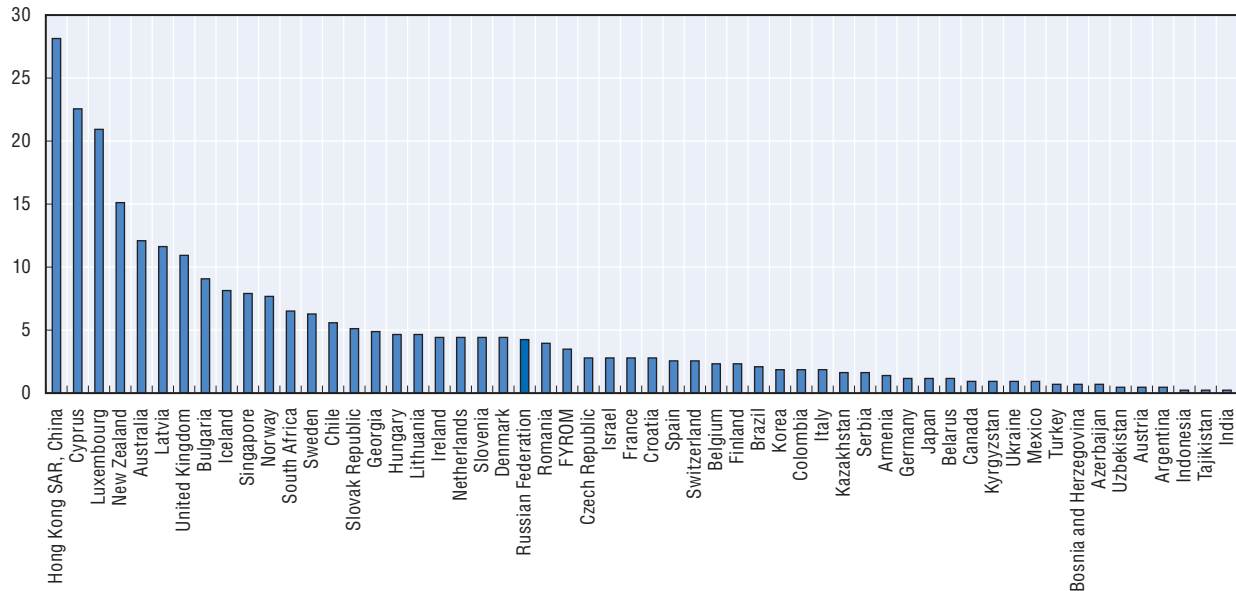
Source: Singer, Amorós and Arreola (2015) Global Entrepreneurship Monitor 2014 Global Report.

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New business density

Further evidence on the performance of the Russian Federation in new venture creation is provided in Figure 2.5, based on data compiled from official business registers, which shows that although the Russian Federation falls in the centre of the distribution, it performs worse than many mature market economies as well as a number of former Socialist economies that are now part of the European Union.

Figure 2.4. **Number of newly-registered limited liability companies per thousand people of working age (15-64 years), selected OECD and emerging economies, 2012^{2,3}**



Source: IFC/World Bank Entrepreneurship Database, 2012. <http://www.doingbusiness.org/data/exploretopics/entrepreneurship>.

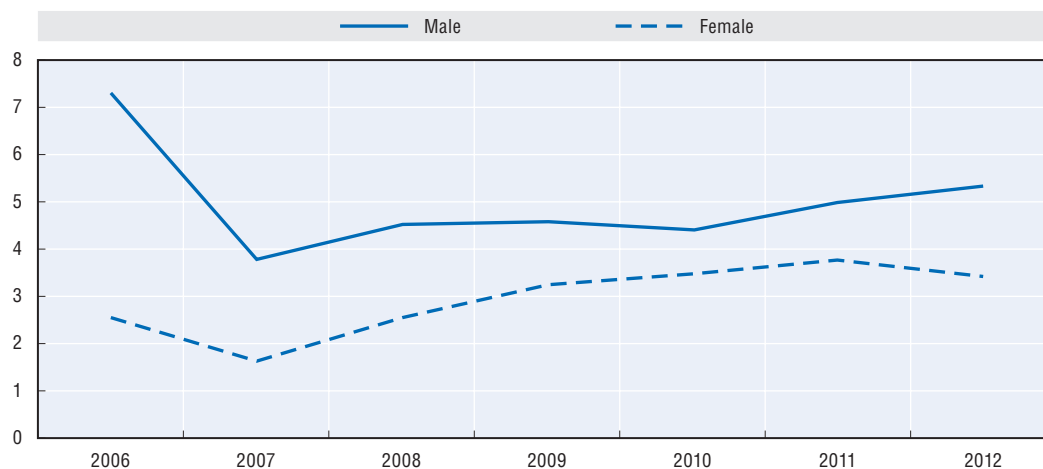
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Gender differences

In many countries, the rate of participation of women in entrepreneurial activity is substantially below the corresponding rate for males. In the Russian Federation, women made up 40% of all early-stage entrepreneurs in 2012. This is one of the highest proportions of in ECA and emerging economy countries. As shown in Figure 2.6, there have been changes in the gap in early stage entrepreneurial activity between women and men since 2006. After a significant reduction in the gap between men and women from 2006-11, the gap grew again in 2012. On the one hand the generally high rate of women entrepreneurship compared with other countries is very positive, implying that SME and entrepreneurship policies in the Russian Federation are well set to increase economic activity by affecting both halves of the population. On the other hand, there is still some more to do in making up the gap with male entrepreneurs. This will require some specific initiatives to ensure that women have equal access to business support, together with some more specific training and coaching initiatives aimed at women. The latter concern relates to evidence from the GEM survey that fewer women feel that they have the necessary knowledge and skills needed to open a business (29% of

adult women compared with 38% of adult males) and that fear of failure is considerably higher among women than among men (51% of women report that fear of failure would prevent them from starting a business compared with 42% of men) (Verkhovskaia and Dorokhina, 2012).

Figure 2.5. **Percentage of adults in early stage entrepreneurial activity in the Russian Federation by gender, 2006-2012**



Source: Verkhovskaia and Dorkhina (2013) Global Entrepreneurship Monitor Russia 2012.

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Entrepreneurial attitudes

Prevailing attitudes towards entrepreneurship in the population as a whole are less positive in the Russian Federation than in many other countries, hindering new business formation rates. As shown in Table 2.6, although 67% of non-entrepreneurs in the Russian Federation considered that entrepreneurship is a good career choice and 66% considered that successful entrepreneurs have high status within the society in 2014, much in line with the average across countries, only 27% perceived good opportunities for starting a business, only 28% believed that they have sufficient knowledge and experience to undertake entrepreneurial activity, and only 4% indicated an intention to start a business within the next 3 years. The Russian Federation is among the weakest countries on these latter measures. There appears to be significant scope to improve media coverage of entrepreneurship given that only 50% of those surveyed in the Russian Federation thought that the media gives a positive image of entrepreneurship, a rate below many other countries (Singer, Amorós and Arreola, 2015). Similarly, whereas there is little difference between Russians and European Union residents in terms of seeing entrepreneurs as job generators, 76% of Russians consider that entrepreneurs take advantage of others, compared with 57% in the European Union (European Commission, 2012).

Table 2.6. **Entrepreneurial attitudes and perceptions, selected OECD and emerging economies, 2013**

Percentage of adults who are not currently an entrepreneur

Country	Start-up intentions	Perceived opportunities	Perceived capabilities	Fear of Failure	Entrepreneurship as a desirable career choice	High status	Positive media attention
Argentina	28	32	58	24	58	52	64
Belgium	11	36	30	49	52	52	51
Brazil	25	56	50	36	0	0	0
Canada	12	56	49	37	57	70	68
Chile	50	67	65	28	69	64	65
China	19	32	33	40	66	73	69
Colombia	47	66	57	31	70	67	74
Croatia	20	18	46	30	63	47	40
Czech Republic (2013)	14	23	43	36		48	
Estonia	10	49	42	42	56	65	43
Finland	8	42	35	37	41	84	67
France	14	28	35	41	59	70	39
Germany	6	38	36	40	52	79	51
Greece	10	20	46	62	58	66	46
Hungary	14	23	41	42	47	72	33
India	8	39	37	38	58	66	57
Indonesia	27	45	60	38	73	78	85
Ireland	7	33	47	39	49	77	76
Israel (2013)	24	47	36	52	61	80	49
Italy	11	27	31	49	65	72	48
Japan	3	7	12	55	31	56	59
Korea (2013)	12	13	28	42	51	68	68
Latvia (2013)	23	35	48	42	61	59	59
Lithuania	20	32	33	45	69	58	55
Luxembourg	12	43	38	42	41	68	44
Mexico	17	49	53	30	53	51	45
Netherlands	9	46	44	35	79	68	56
Norway	5	63	31	38	58	83	0
Poland	16	31	54	51	63	56	55
Portugal	16	23	47	38	62	63	70
Romania	32	32	48	41	74	75	71
Russian Federation	4	27	28	39	67	66	50
Singapore	9	17	21	39	52	63	79
Slovak Republic	15	24	54	36	45	58	53
Slovenia	11	17	49	29	53	72	58
South Africa	10	37	38	25	70	73	73
Spain	7	23	48	38	54	49	46
Sweden	8	70	37	37	52	71	60
Switzerland	7	44	42	29	42	66	50
Thailand	22	47	50	42	74	71	80
Turkey (2013)	28	39	52	30	64	74	53
United Kingdom	7	41	46	37	60	75	58
USA	12	51	53	30	65	77	76

Source: Singer, Amorós and Arreola (2015) Global Entrepreneurship Monitor 2014 Global Report.

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Informal economy

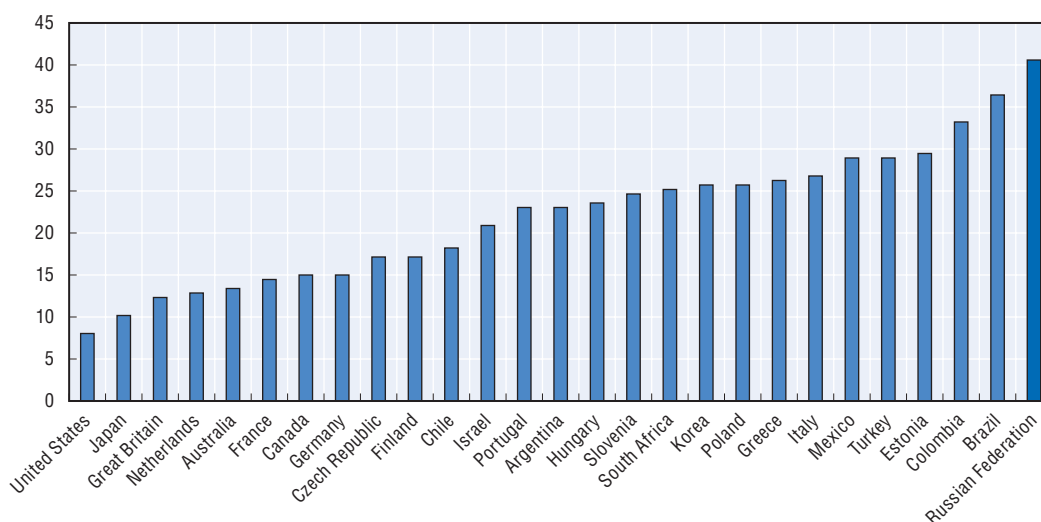
Hidden and untaxed employment and business activity is present in all countries, involving both businesses that are not registered and not compliant with business and tax laws and regulations and businesses that are registered but evade some taxes by declaring

only some of their income and workforces. In some senses this activity has a positive side, in that it provides work and income opportunities to people who might otherwise have none and offers the makings of an entrepreneurial population and entrepreneurial activity. However, a large informal sector is generally a burden to economic growth because of its low productivity and low growth ambitions (in turn reflecting lack of access to credit, training and legal protection etc.), its negative effects on formal activity (for example by undercutting prices), and its undermining of fiscal revenues and public investment.


The Russian Federation has a large informal economy relative to OECD economies but is more in line with non-OECD comparator countries in similar income groups. Figure 2.7 shows the level of informality estimated by the Schneider approach, which estimates the size of the informal sector from a number of observable factors that are correlated with informality. This measure suggests that the extent of informal economic activity is somewhat greater in the Russian Federation than in comparators such as Brazil and Mexico, and significantly higher than in other post-Socialist central and eastern European countries such as Poland and the Czech Republic.

Figure 2.6. **The estimated scale of the informal economy, Schneider definition**

Percentage of economic activity, 2007



Source: OECD (2011), OECD Economic Surveys: Mexico 2011, OECD Publishing, Paris, http://dx.doi.org/10.1787/eco_surveys-mex-2011-en based on International Labour Office (2011). Statistical Update on Employment in the Informal Economy, International Labour Office, Department of Statistics.

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Using an alternative survey-based approach, the International Labour Office (2011) estimated that there were 7.78 million informal sector jobs in the Russian Federation in 2011 (i.e. jobs which lack legal protection for employment benefits), representing 12.1% of total non-agricultural employment. While this was lower than many comparator countries (it compares for example to 32.1% of non-agricultural employment in Argentina, 24.3% in Brazil, 52.2% in Colombia, 34.1% in Mexico, and 9.4% in Ukraine), it still suggests that the Russian Federation has a substantial informal sector, and one that is much larger than in the most advanced economies. At the same time, the informal activity is not enough on its own to explain the low rates of formal activity in the SME sector in the Russian Federation. For example, even attributing all the informal jobs estimated by the International Labour Office survey to estimated SME employment would still leave the Russian Federation with an SME employment rate substantially below the OECD average.

A number of policy measures may be developed with the aim of converting informal to formal entrepreneurship activity. As well as better policing, they include simplifying business regulation and compliance costs, increasing the security of property rights to create “institutional trust” among entrepreneurs and raising awareness among entrepreneurs of the disadvantages of remaining in the informal sector. However, any measures that seek to reduce informality risk depriving households of work and income if they are not able to continue in the formal sector. The balance between deterrence as a policy to reduce informality and finding positive ways in which to incentivise formality is difficult to find and is a concern shared by many countries. Box 2.1 gives the example of a good practice initiative in Italy which provides informal entrepreneurs with incentives to formalise their businesses and employment.

Box 2.1. Addressing the informal economy, CUORE Programme, Italy

Description of the approach

The Urban Operational Centres for Economic Renewal (*Centri Urbani Operativi per la Riqualificazione Economica*, CUORE) project was started by Naples municipal government and the University of Naples in 1999 and has subsequently been extended to other cities across Italy. It involves the creation of a series of neighbourhood service centres in which business development advisors linked to the University make contact with entrepreneurs and potential entrepreneurs who may be operating in the informal sector. The advisors, who are familiar with local conditions, offer information on business regulation, business development advice, pathways to relevant government business support programmes and customised business regularisation procedures for undeclared businesses or workers requesting formalisation. They make door-to-door visits and telephone contacts targeting local workers, employers, and unemployed people as well as offering drop in support at the centres. They also train and support municipal staff responsible for business regulation in dealing with informal entrepreneurs. The primary objective is to develop a friendly relationship between the state and informal entrepreneurs, with the government offering help but expecting something in return.

Results

An evaluation in 2005 of the four original neighbourhood service centres established in Naples indicated the following results:

- Approximately 8 000 contacts were made by telephone, in person at the centres or during face-to-face visits. Some 3 580 people received support for setting up a business, 1 500 of whom were women.
- 1 280 businesses that were engaged in undeclared work received advice on their situation, and 326 situations were resolved through formalisation.
- 80 companies were supported to participate in regional trade fairs and received micro support to develop their businesses.

Success factors

One of the factors in the success of this initiative has been the involvement of the University, which helped to the business advisors to obtain the trust and involvement of the community, both because of their independence and their understanding of local businesses needs and cultures. It is also critical that the centres offer support to informal entrepreneurs and not simply threats. The neighbourhood service centres also have the flexibility to design and offer services that fit the needs of their local communities. Furthermore, continuous training of neighbourhood service centre staff has been important, including support in adapting to changes in the local environments in which they are operating.

Box 2.1. Addressing the informal economy, CUORE Programme, Italy (cont.)

Obstacles and responses

The project has encountered certain challenges, including:

- Mistrust and reticence among entrepreneurs, who are often reluctant to participate for fear of being exposed to organised crime. The project therefore has to be embedded within a wider strategy for reducing criminality.
- Local governments often see reducing the informal sector as a one-off action that will be quickly completed and have been reluctant to provide the sustained funding necessary to intervene with new people coming into informality.
- There have been difficulties in reconciling the obligations of agencies responsible for pursuing those breaking the law with the economic development objective of seeking to assist businesses to formalise and grow.

Addressing these issues has required continued flexibility in operation.

Relevance to the Russian Federation

The Russian Federation has significant numbers of informal entrepreneurs whose contribution to the economy is unduly limited. A deterrence approach (sanctions against those found breaking the law) has been relatively ineffective and ways need to be found to coordinate state institutions to make formality more attractive. This model shows one approach, based on outreach and flexible service support through neighbourhood service centres established in urban areas with high informality levels.

Further information

www.comune.napoli.it/flex/cm/pages/ServeBLOB.php/L/IT/IDPagina/19156

www.eurofound.europa.eu/areas/labourmarket/tackling/cases/it001.htm

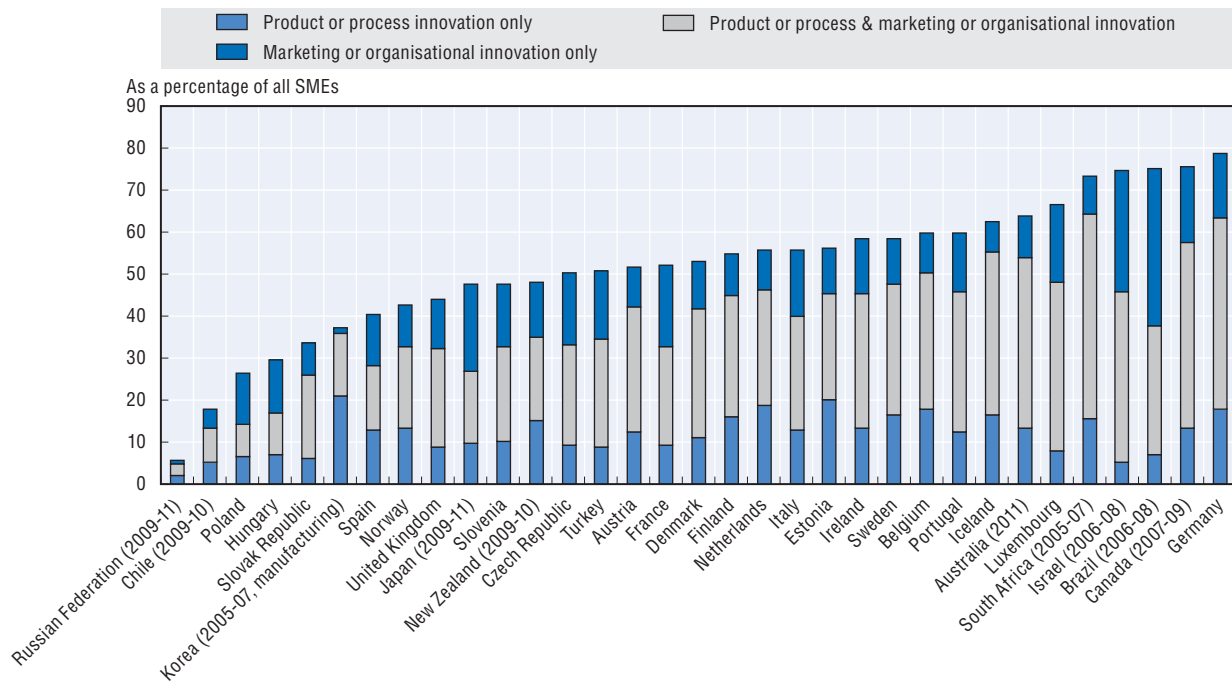
Source: Based on information from Naples municipal government and Eurofound

SME innovation

Innovation in the form of advances in products, processes, organisational methods and marketing techniques is a key factor in the competitiveness of territories and a vital ingredient for growth-oriented start-ups and SMEs. However, as shown in Figure 2.8, innovation activity is reported by less than 6% of SMEs in the Russian Federation, well below rates of typically around 50% in OECD countries (Figure 2.8). As shown in the chart, the proportions are low both for marketing and organisational innovation on the one hand, and product and process innovation on the other and very few Russian SMEs do both.

The finding of low innovation rates among SMEs in the Russian Federation is backed up by the 2011 SME Census in the Russian Federation, which reveals that in 2011 just 1.6% of SMEs made specific expenditures on innovation (2.8% of medium-size businesses, 1.6% of small businesses and 1.3% of micro enterprises) (Rosstat, 2011). Similarly an innovation survey by the Higher School of Economics in Moscow found that only 10% of businesses across the Russian Federation reported undertaking technological innovation activity in 2008 (a proportion that had been constant over the previous decade), and that innovative products represented only approximately 5% of total sales of Russian enterprises compared with a European Union average of approximately 10% (OECD, 2014).

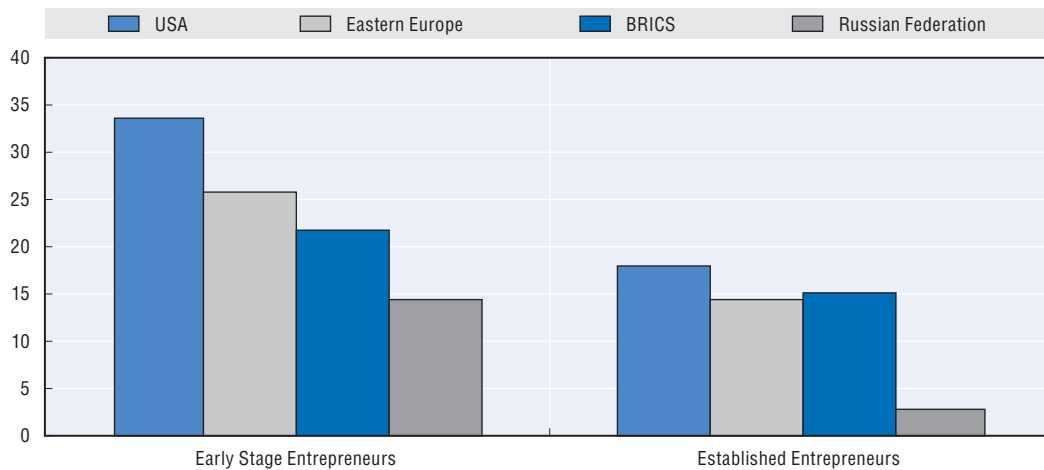
Figure 2.7. **Innovating SMEs by type of innovation**
2008-10 or latest available years



Source: OECD (2013), Innovation types by firm size, 2008-10: As a percentage of all SMEs and large firms, in OECD Science, Technology and Industry Scoreboard 2013, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/sti_scoreboard-2013-graph165-en.

StatLink <http://dx.doi.org/10.1787/888933271752>

Figure 2.8. **Index of novelty of products/intensity of competition of early-stage and established entrepreneurs across countries, 2012**



Note: To measure a country's potential for innovation an index is used from a combination of indices of product novelty and intensity of competition. This reflects a quantity of entrepreneurs who consider that their product or service is new and novel for all or several consumers and at the same time has little or no competition.

Source: Verkhovskaia and Dorokhina (2013) National Report Global Entrepreneurship Monitor Russia 2012, p. 41.

StatLink <http://dx.doi.org/10.1787/888933271768>

In addition, 72.5% of early-stage and 87.9% of established entrepreneurs in the Russian Federation reported that they were offering products and services that were not that new for consumers in 2012 (a proportion that had been increasing) while 94.3%

of established entrepreneurs and 89.5% of early stage entrepreneurs did not use newer technology in their business activity (Verkhovskaia and Dorkhina, 2013). On the basis of a composite index that takes together the novelty of products and the degree to which they do not have direct competitors, Figure 2.9 indicates that both early-stage and established entrepreneurs in the Russian Federation tend to be substantially less innovative in their products and services than their counterparts in the USA, Eastern Europe and BRICS countries.

In contrast, Russian businesses appear to be very active in their use of the internet; by 2012, two-thirds of surveyed businesses were using their own websites, compared with less than one-half in ECA and Upper Middle Income countries (World Bank/IFC, 2012).

High-growth entrepreneurship

There is substantial international evidence that in any cohort of firms a minority of rapidly-growing SMEs typically generate a majority of the new jobs (OECD, 2010). In some countries, they also tend to be associated with better export performance. These two features make them an important target of policy. Unfortunately, there are no official statistics on high-growth enterprises in the Russian Federation. However, according to GEM data for 2012, entrepreneurs expecting to create more than 20 jobs in the five years after business creation represented 0.46% of the adult population in the Russian Federation in 2014, compared with 0.40% in Brazil, 0.28% in Mexico, 1.01% in China and 2.89% in the United States. Put in other terms, according to GEM data for 2011, of those involved in entrepreneurship activity, 9.8% of entrepreneurs in the Russian Federation expected to employ 20 people in 5 years' time compared to 1.5% in Mexico, 2.3% in Brazil, 6.5% in China and 21.0% in the USA. It is important that these entrepreneurs in the Russian Federation are given the opportunities to achieve their growth ambitions. In this respect, a separate study (Morris, 2011) found that the median turnover growth rate of high-growth aspiration entrepreneurs in their most recent full year of trading was 453% in China, 269% in South Africa, 311% in Brazil, and 216% in India but only 150% in the Russian Federation, suggesting that high-growth entrepreneurs in the Russian Federation have been finding it more difficult to achieve their aspirations than in other BRIC countries.

Conclusions and recommendations

There is tremendous under-exploited potential in SME and entrepreneurship activity in the Russian Federation, demonstrated by substantial shortfalls with OECD, ECA and emerging economies in numbers of SMEs per head of population, employment in small businesses, rates of new business start-ups, and levels of SME investment and innovation. Making up these shortfalls can be expected to have a dramatic impact on the Russian Federation economy, in terms of substantial job creation and income generation, increased investment, competition and productivity and a diversification of the economic base away from its current dependence on commodity exports. One of the strengths that is already there to build on is that entrepreneurship in the Russian Federation already has a relatively good gender balance, although there is still some ground to make up in the female rate of entrepreneurship relative to that for males.

One of the challenges will be to improve the attitudes to entrepreneurship in Russian society. At only 3% of the population, the proportion of adults in indicating an intention to start a business in the Russian Federation is one of lowest internationally. In addition, a majority of non-entrepreneurs doubt that they have sufficient knowledge and experience to undertake entrepreneurial activity and have a relatively strong fear of failure. Changing long-established attitudes is a challenging prospect for Russian policy makers but a necessary one if entrepreneurship is to gain the legitimacy it needs to become embedded in Russian society and economy.

Another issue to address is dependency of many Russian households on a sizable informal sector. The large scale of informality reflects a number of institutional deficiencies, and reducing the size of the informal economy will require more than a systematic approach to policing it but rather measures to tackle its causes. Efforts should also be gradual and careful, since it needs to be recognised that informal activity is currently providing jobs and contributing to reducing social and economic exclusion at least in the short term.

SME innovation rates are also relatively low in the Russian Federation, as measured by rates of product/process innovation and rates of marketing/organisational innovation and by the novelty value of the products and services of Russian enterprises for their customers. Improving the innovative performance of SMEs is one of the most important current policy priorities the Russia Federation, which is crucial to future competitiveness. In addition, there is some evidence that growth-orientated entrepreneurs in the Russian Federation find it more difficult to achieve their aspirations than in other BRICS countries. Developing a more substantial high-growth firms sector in the Russian Federation is a further key policy challenge.

In order to meet these challenges, the following key policy recommendations are offered:

Key policy recommendations on SME and entrepreneurship performance

- Increase numbers of SMEs and their employment through a combination of extensive measures aimed at increasing the level of entrepreneurship across the population and more targeted and specialised support for growth-oriented entrepreneurs and enterprises.
- Promote growth of manufacturing SMEs in particular by increasing the focus of SME programmes on innovation, exporting and investment in physical and human capital and setting targets for the participation of manufacturing SMEs in these programmes.
- Promote positive attitudes to entrepreneurship through a national entrepreneurship awareness campaign involving the media and comprehensive integration and teaching of entrepreneurship teaching across the educational system.
- Facilitate transfers of entrepreneurial activity from the informal to the formal economy by removing undue obstacles to formal entrepreneurship in the tax and regulatory system and supporting informal entrepreneurs to upgrade their businesses and tap into new sources of demand.
- Increase SME innovation across all sectors by building the innovation and growth capacities of new and existing enterprises and their management teams.

Notes

1. The notion of efficiency-driven economies is used by the World Economic Forum and others such as GEM to indicate countries in an intermediate stage of economic development (between factor-driven and innovation-driven development), where further growth is strongly connected to increases in the efficiency of production process and product quality
2. The information in this document with reference to « Cyprus » relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the Island. Turkey recognises the Turkish Republic of Northern Cyprus (TRNC). Until a lasting and equitable solution is found within the context of the United Nations, Turkey shall preserve its position concerning the “Cyprus issue”.
3. The Republic of Cyprus is recognised by all members of the United Nations with the exception of Turkey. The information in this document relates to the area under the effective control of the Government of the Republic of Cyprus.

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From:
Russian Federation: Key Issues and Policies

Access the complete publication at:
<https://doi.org/10.1787/9789264232907-en>

Please cite this chapter as:

OECD (2015), "SMEs and Entrepreneurship in the Russian Federation", in *Russian Federation: Key Issues and Policies*, OECD Publishing, Paris.

DOI: <https://doi.org/10.1787/9789264232907-6-en>

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