

## Small business in Russia: need for state financing backing (International Conference on Applied Economics (ICOAE) 2014)

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**Abstract.** In Russia small business is underdeveloped compared to other countries although unemployment rate is high, especially in some constituents of the Russian Federation. The authors have analyzed financial environment of small business performance. The analysis of this environment has revealed the need for state financing backing of small business entities. Tax remissions, public contract quotas, service tariffs benefits, state guarantee, etc. are financial backing tools. However current forms of state financing backing are insufficient. The need for additions to forms of state financing backing enabling to develop small business is substantiated in this article.

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### Introduction

Small entrepreneurship institute is a constituent part of any country's economy. It is destined for solution of fundamental modern problem, namely employment of population. According to the data from Rosstat (Russian Statistics Committee) number of the unemployed people of the Russian Federation is going down. Officially, there were 1,065 thousand of registered unemployed people in 2012, but following sampling employment investigations of population, number of such people was 4,131 thousand. But to our opinion these data does not include hidden unemployment problem, especially in regions, to the full extent.

In the Russian Federation the rate of population occupied in small business is small compared to other countries and amounts to 17-18%. Statistics shows that 11,683.0 thousand people were involved in small business, and average annual number of the employed amounted to 67,968 thousand people in 2012. The EU countries' rate of population occupied in small business ranges from 55% to 75%, and this rate exceeds 50% in the USA. That is why the Russian Federation has great possibilities for involvement of unoccupied population in small business, what will solve the problem of unemployment including hidden unemployment. Small business will not develop by itself. Certain financial environment of its performance, including state financing backing, is required. The study has found that almost all countries use various tools of state financing backing of small business. Granting of state loan guarantee to small entrepreneurship is the most popular tool of state financing backing. Some countries use microfinancing, export operation guarantees, tax

remissions as targeted credits (for instance, for innovations) under the character of other measures of financial backing of small entrepreneurship institute. Besides, a series of countries uses such tool as property support by means of absolute assignment and (or) assignment for use of state (municipal) property (business incubator zones, technology parks, and finance lease), as well as information and consultancy support. By no means all tools of state financing backing of small business entities are used in Russia, that is why the authors believe that their number has to be enlarged.

### Research and publication analysis

The following authors analyzed the development of small business in their research papers: Valentin, A. and T. Henschel approach the problem by confirming the positive impact of guarantee banks on SME lending [1], Walczak, D. and G.Voss highlight the areas of financial support for entities from the SMEs sector provided by means of the BGK budget funds [2], Cowling, M., W. Liu, A. Ledger, consider the problem of demanding for external finance changed as the economy entered recession and whether external finance became more difficult for entrepreneurs to access as the recession progressed in UK [3], De Maeseneire, W. and T. Claeys explore the problem of expecting SME severe financing constraints for foreign investments and provide an explorative empirical study with both the demand and supply side of FDI finance [4], Hurst, E. and B.W. Pugsley in their research paper suggest that the importance of entrepreneurial talent, entrepreneurial luck, and financial frictions in explaining the firm size distribution may be overstated [5]. In our paper we show the impact of

financial environment on small business development in Russia.

### Research objective

The objective is the research of financial environment of small business performance in Russia, as exemplified by the Republic of Tatarstan which is one of developed constituent entities of the Russian Federation, for revelation of its development possibilities through the system of state financing backing.

### Findings

Small business is attractive not only for the federal but also for the regional authorities. Though general conditions of small business development are defined by the federal authorities, we should not underestimate the importance of the regional authorities as well. Before everything else this is connected with the fact that Russian economy has territorial aspect. In view of the results of statistics official unemployment of Russia amounted to 5.5% in 2012. Specifically, the highest unemployment rate of 13.1% was in the North Caucasian Federal District, and the lowest unemployment rate of 3.1% observed in the Central Federal District. That is why not only federal but also regional authorities have to solve the problem of unemployment within their powers, and thus provide conditions for its reduction. Number of enterprises which falls on 1000 people is also an index characterizing developmental level of small entrepreneurship. At least 40 small entrepreneurship entities fall on 1000 inhabitants of the countries of the European Union. In Russia this index varies in different regions and averaged 12.85 entities in 2011 and 13.98 entities in 2012. Number of small enterprises which falls on inhabitants of Moscow and St. Petersburg amounted to 21 entities in 2011 and 33 entities in 2012. This index came to 12.1 and 13.5 correspondingly in the Republic of Tatarstan. Maximum index accrues to the North-Western District: 19.08 entities in 2011 and 23.7 entities in 2012. 5 small entrepreneurship entities in 2011 and 5.34 entities in 2012 fell on 1000 inhabitants of the North Caucasian Federal District. In this regard, from our point of view, providing stimulation for small entrepreneurship institute development, especially in regions with high unemployment, is the high-priority problem which shall be solved by both federal and regional authorities.

Criteria of the assignment of enterprises to small entrepreneurship entities are important for small business research. Many countries consider a number of employees working in an enterprise to be the only consistent criterion. According to a number

of employees European Union countries distinguish micro-enterprises with at least 9 employees, enterprises with 10-49 employees are qualified as small enterprises, enterprises with 50-249 employees correspond to medium-sized enterprises, and large enterprises have more than 250 employees. But there are other criteria of defining an enterprise as small entrepreneurship entity in the European Union. For example, in France they do not include agricultural and financial sector enterprises in the category of small and medium-sized enterprises from 2008 onwards. In Czech Republic there is a limitation of turnover volume which cannot exceed 250 million Czech korunas, and a limitation of assets or property which cannot exceed 180 million Czech korunas for defining a small enterprise. In the USA those enterprises where number of employed does not exceed 99 people are classified as small enterprises. In Canada enterprises with no more than 100 employees and enterprises ran by individually employed persons without hiring of labor are classified as small entrepreneurship entities. Industrial specific character is taken into consideration in France and Great Britain. In Sweden they apply additional qualitative criteria of attribution of enterprises to small ones, such as: growth stage, sector profile, geographical area of activities. Russian legislation also establishes such criteria [6, 7]. Thus, a number of employed stands out among such criteria: up to 15 people for micro-enterprises, up to 100 people for small enterprises, and up to 250 people for medium-sized enterprises. Limitation is placed on sales (work, services) proceeds for differentiation of small and medium-sized entrepreneurship entities: 60 million rubles for micro-enterprises, 400 million rubles for small enterprises, and 1000 million rubles for medium-sized enterprises. Besides, there are limitations on cumulative participatory interest of the Russian Federation, constituents of the Russian Federation, municipal units, foreign legal entities, non-governmental and religious organizations (associations), charity and other foundations in share (joint-stock) capital (share fund) of a legal entity (small enterprise) shall not exceed twenty-five percent; participatory interest belonging to one or several legal entities other than small or medium-sized entrepreneurship entities also shall not exceed twenty-five percent.

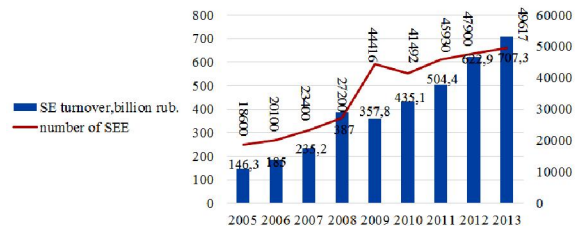
It was not until fairly recently (early in the 1990s) that small business has started its development in Russia, and its significant growth falls on the last 8 years, i.e. on pre-recession and even recession years. Dynamics of small entrepreneurship institute development for the last 19 years as of from 1994 through 2013 is shown in Figure 1.



**Fig. 1. Number of small entrepreneurship entities in Russia as of from 1994 through 2013 [8]**

Industry analysis of small entrepreneurship entities development has revealed that wholesale and retail trade belongs to the most popular types of economic activity of small enterprises. Statistics shows that in 2012 this industry ratio including enterprises performing maintenance of motor vehicles, motor bikes, household goods, and personal appliances was equal to 40.7% of their total number, and number of employed was equal to 37.1% of the total number of employed in small business [8]. Significant part of small business enterprises is engaged in real estate operations, rent, and service rendering (20.3% of total number), and 21.4% of the total number of employed is occupied in this sphere. Small business is presented worse in other sectors of economy. In 2013 the situation practically didn't change. Our second conclusion involves necessity of stimulation of small entrepreneurship development in sectors where it is presented least of all. It can be achieved by usage of tools of administrative and legal control, tools of budget and tax regulation including targeted state financial backing.

For research of financial environment of small business performance we picked the Republic of Tatarstan which is a sufficiently successful constituent of the Russian Federation. It ranks among constituents of the Russian Federation which are given high ratings by international rating agencies. In January 2014, Fitch Ratings confirmed long-term foreign and local currency issuer default rating (IDR) of the Republic of Tatarstan of the Russian Federation at BBB and short-term foreign currency IDR at F3. National long-term rating was confirmed at AAA(rus), long-term rating outlook was considered as sustainable. Quantity indexes of small enterprises and their turnover are the measure of small entrepreneurship development in the region. Analysis of these indexes in the Republic of Tatarstan provides evidence of their growth, though there was a heavy drop in small enterprises' turnovers during the recession year. But we can observe indexes' growth after recession years (Figure 2).



**Fig. 2. Small entrepreneurship turnover dynamics and number of small business pattern entities in the Republic of Tatarstan [9]**

Analysis of the sectoral structure of small and medium-sized business entities turnover in the Republic of Tatarstan confirms national tendency. The bulk of small and medium-sized business entities turnover of the republic falls on wholesale and retail trade which composed 49.8% in 2012. I.e., this is national problem of small business sectoral structure. At the same time agricultural stake in the turnover amounts to just 2.4%, and transport and communications stake amounts to 3.5%.

Analysis of some financial operating rates of small business entities in the Republic of Tatarstan testifies that before the crisis of the year 2009 ratios of return on assets and sales had a tendency to growth, and after the crisis they looked down. In 2012, return on assets of Tatarstan's enterprises amounted to 12.8%, and return on sales amounted to 11.3%. At the same time rates of small enterprises composed 3% and 3.8% correspondingly in 2012. Moreover it shall be noted that significant upswings of these rates were not observed as of 2005 through 2012. Certainly, productivity of small business enterprises is smaller than productivity of medium-sized and large business, but still measures contributing towards productivity of small entrepreneurship entities stay essential. Therefore it is our belief that state financing backing can make small business more attractive.

In any constituent development of small entrepreneurship institute considerably depends on statutory resolutions carried at the federal level. But we cannot underestimate powers of constituents of the Russian Federation in resolution of this institute problem. These powers touch upon issues of granting tax remissions, public contracts, rate policy, programs of state financing backing of small business, etc. Issues of loan services, insurance, microfinancing of small business are not classified as powers of constituents of the Russian Federation. Considering financial environment of small entrepreneurship development, tax remissions are usually given attention. There are special tax treatments for small entrepreneurship entities. The

study has found that ratio of tax revenues from small entrepreneurship entities is rather insignificant in the bulk of tax revenues of the Republic of Tatarstan. Thus, it was 6.91% in 2010, 5.82% - in 2011, 6.16% - in 2013. Moreover number of payers using special tax treatments is smaller than total number of registered organization-payers in the Republic of Tatarstan. Besides, decrease of individual entrepreneur-payers quantity by 17,914 was in evidence in 2010-2012. Decrease of individual entrepreneurs quantity in 2012 was conditioned by different circumstances. Thus, in 2009 rural population of the Republic of Tatarstan was obtaining subsidies for business development which amounted to 60 thousand rubles, if they were registered as individual entrepreneurs. Currently they are losing their status of individual entrepreneurs who obtained a subsidy for business development as part of self-employment program. Increase in premium, which started on 1 January, 2013, also had effect on sharp decrease of individual entrepreneurs quantity.

Option to choose an object from which taxes will be deducted is a peculiarity of the simplified tax system (hereinafter referred to as STS). Tax with rate of 6% rate is paid when "revenues" variant is chosen, and tax with rate of 15% rate is paid when "revenues less charges" variant is chosen. Since 1 January, 2009, regional laws allow constituents of the Russian Federation to determine differentiated tax rates according to the simplified tax system, as a result of which rate percent can range from 5% to 15%. Many constituents of the Russian Federation, including the Republic of Tatarstan, employ this tool of stimulation of small business entities [10]. Limited number of taxpayers falls within reduced 5% rate taxation in the Republic of Tatarstan, but if we compare it with other regions of the Volga Federal District, we will notice that other taxpayers of the Republic of Tatarstan fall not within maximum 15% rate taxation, but within 10% rate.

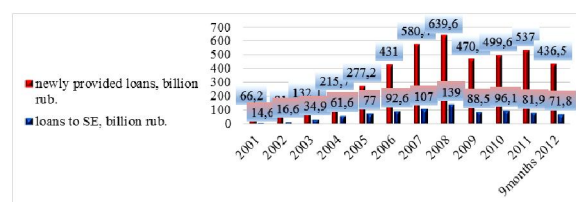
Since 1 January, 2013, patent system of taxation was introduced, and this system shall replace the simplified tax system based on patent which was good till the end of 2012. Analyzing regional laws On Patent System of Taxation for the Volga Federal District we can conclude that the Republic of Tatarstan belongs to regions with largest attributes of size of potentially-enable revenue of per unit of physical indicator of individual entrepreneur activity, giving way to the Nizhni Novgorod and the Penza Regions. Inability to reduce value of the patent by the sum of insurance contributions for compulsory insurance is a disadvantage of this taxation system. It augments fiscal duty of taxpayers, disadvantages individual entrepreneurs who switched to the patent system in 2013 in comparison with entrepreneurs

who use the simplified tax system based on patent. According to the previously working rule, patent value could be reduced by the sum of contributions for compulsory pension, health, and social insurance. That is why small business entities switched to this form with reluctance. Only 870 accounted taxpayers did it in 2013, whilst there were 3,849 taxpayers in STS based on patent in 2012.

Except for special tax treatments, Russian legislation provides possibility to set some tax exemptions (income tax relief, transport tax privilege, land tax exemption and corporate property tax relief). In the Republic of Tatarstan such exemptions are set only for residents of SEZ Alabuga which is industrial production special economic zone. It is worth noting that among six special economic zones acting in Russia only that one is acknowledged to be successful.

Credit facilities, which are same in the whole country, are an important term for small business development. Analysis of banking sector activity in the Republic of Tatarstan has revealed that there is a positive dynamics of loans provided to small entrepreneurship institute from 2001 to 2012. This index came to 14.6 billion rubles in 2001, and it increased 57.2 billion rubles in 2012. But proportion of loans newly provided to small business enterprises has a tendency toward decrease from 22.05% in 2001 to 16.46% in 2012.

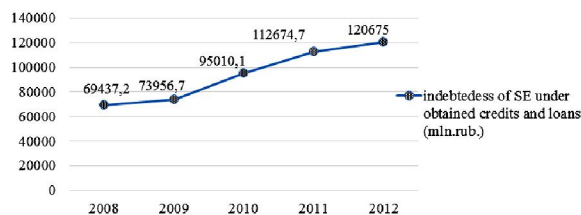
Analysis of loan services to small entrepreneurship entities of the Republic of Tatarstan has revealed that these services are not privileged but even severer. Loan companies often provide loans to small entrepreneurship entities on the usual terms for fear of financial insolvency of the said entities. Interest rate ranges from 16% to 18%. 18% interest rate can be set for newcomers of entrepreneurship, and in case of non-coverage of loans it may be increased to 20%. Currently medium term of loan services to small business is 6-12 months, and maximum term is 2 years.



**Fig. 3. Dynamics of loans provided to small entrepreneurship institute in the Republic of Tatarstan**

Decrease of proportion of loans provided to small entrepreneurship in the total loan portfolio of banks in the Republic of Tatarstan is explained by unwillingness of loan companies to lend money to

this institute of economy due to financial imbalance of the latter, which in turn increase indebtedness of small business pattern enterprises under obtained credits and loans (Figure 4).



**Fig. 4. Indebtedness of small entrepreneurship under obtained credits and loans (mln. rub.) [9]**

Whereas banks can provide more long-term loans to other business patterns. Certainly, banks cannot support small business without benefits and reimbursements of the state. The Government of the Russian Federation considers various options of financial backing of banks for loan services to small business. To our opinion, the best form of small business support will be establishment of The Agency of Loan Guarantees for Small Business as non-bank depository institution with capital amounting to 30-35 billion rubles. Establishment of such agency will make it possible to implement extra measures of stimulation of small and medium-sized entrepreneurship development, including guarantee support of funds which provide business with security for credits and loans. Measures aimed at implementation of two-level guarantee system, where the Guarantee Fund of the Russian Federation is a counterpart, and the Guarantee Fund of the Republic of Tatarstan is a guarantor, are also considered in the Republic of Tatarstan. Such system will enable to minimize and allocate risks between these two guarantee funds of different tiers of authority.

Analysis of small entrepreneurship entities activity in the insurance market has revealed that small enterprises do not take advantage of insurance products against risks due to lack of financial resources. That is why the role of state financial backing in terms of small business guaranties is so important.

Public contracts placed for small entrepreneurship entities are one of the tools of state financial regulation of small entrepreneurship institute. Therewithal the main objective is not only new job formation, but also promotion of competition, diversification of small enterprises. Analysis of auctions for the last four years has revealed that prices of completed contracts are rising, but interest of small business remains low. In 2012, interest for needs of government authorities of constituents of the Russian Federation amounted to

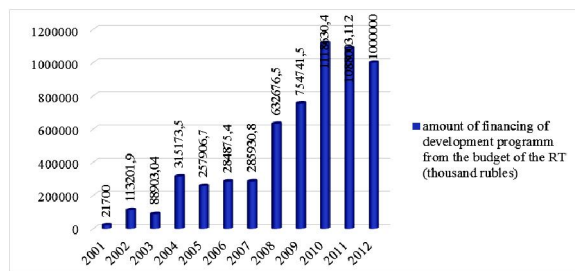
1.3%, and interest for public needs amounted to 5.3%. It shall be noted that Federal law #44-FZ On Contractual System in the Sphere of Central and Local Government Procurement oriented to greater central and local government procurement access of small enterprises has been enacted on 5 May, 2013. According to this law, customers are obliged to make at least 15% of cumulative annual output of procurement from small entrepreneurship entities and socially oriented noncommercial organizations starting from 1 January, 2014. According to our sources the value of one contract concluded for public needs with small entrepreneurship entities amounted to 274 thousand rubles in 2009, 306 thousand rubles - in 2010, 370 thousand rubles - in 2011, 425 thousand rubles - in 2012, what can be considered a positive occurrence.

Small business development program backing is one of the forms of state financial backing of small business entities. Such programs are financed both by federal and regional budgets. The Republic of Tatarstan takes part in contests of the Ministry of Economic Development of the Russian Federation for provision of federal funds for the purpose of financing events of small and medium-sized entrepreneurship state backing in constituents of the Russian Federation. For instance during the period of 2005-2010 the Republic of Tatarstan received federal funds amounting to 2,300.6 million rubles as subsidies and subventions, including for the purposes of:

- establishment and development of business incubator zones: 93.6 million rubles;
- export-oriented small business entities backing: 35 million rubles;
- establishment and development of foundations for assistance to small enterprises in science and technology: 275 million rubles;
- development of system of security for credit and lease contracts, and backing of agricultural consumer credit co-operatives: 22.4 million rubles;
- co-financing of some measures of republican small entrepreneurship backing programs: 1,871.9 million rubles (loans, leasing, credit interest rate indemnity, innovation contests, guaranty fund, establishment of Master industrial park, grant and education programs, maintenance of business incubator zones, sponsoring expenditures connected with affiliating with power supply network facilities, informational support campaign, information and consulting services, etc.).

Significant means for small business development are devoted from federal budget resources of the Republic of Tatarstan. Dynamics of allocations for financing of small entrepreneurship development programs from the budget of the

Republic of Tatarstan for the period from 2001 to 2012 is shown in Figure 5.



**Fig. 5. Amount of financing of small entrepreneurship development programs from the budget of the Republic of Tatarstan for the period from 2001 to 2012 (thousand rubles)**

It may be noted that there is a tendency of growth of these expenditures, i.e. necessity of financial backing of small entrepreneurship entities is understood. Growth of small business financing in volume has been notably increasing since 2008 due to increase of number of small enterprises, as well as their active involvement in these programs. 3,334.0 million rubles had been devoted for small business financial backing from the budget of the Republic of Tatarstan for the period from 2005 to 2010. These means were directed to financing of such programs as Leasing-Grant, Innovations, Social Entrepreneurship. Leasing-Grant became the largest sub-program of state financial backing, and it is performed via subsidy of a part of expenditure incurred due to first installment (advance payment) upon conclusion of financial lease contract. But performed analysis has revealed that share of expenditure for small business backing in the republican budget is small and amounts to less than 1% in the last 10 years. Since 2011, the list of regional small business backing programs in the Republic of Tatarstan has been expanded by:

- "Implementation of expenditure subsidy instrument for small business entities and small entrepreneurship infrastructure objects connected with affiliating with power supply network facilities";
- "Development of business incubation processes and support of current activity of business incubator zones";
- "Subsidy to small and medium-sized entrepreneurship entities of the Republic of Tatarstan which are residents of industrial site located within the Republic of Tatarstan";
- "Sponsoring expenditures of small entrepreneurship entities connected with education";
- "Support of young entrepreneurs";
- "Sponsoring expenditures of agricultural co-operative for payment of loan interest raised in

Russian credit institutions".

I.e., the list of programs is expanded. That is why there is backing growth as evidenced by data in Figure 5. But these measures are not sufficient to make small business development level comparable to other countries.

## Conclusion

All in all small business development in Russia has not progressed to the stage of other developed countries, though there is the problem of unemployment particularly in some regions. The authors believe that small business development can be recommended to rating agencies for valuation of regions investment attractiveness rating in order to stimulate development of small entrepreneurship entities.

Analysis of the sectoral structure of small business entities has revealed that essential part of small business enterprises falls on wholesale and retail trade, that is why the authors believe that it is necessary to stimulate small business in other sectors using various forms of state financing backing. In the case of the Republic of Tatarstan it may be small agricultural enterprises. At most 3% of small and medium-sized entrepreneurship entities turnover fall on agriculture.

The research of small entrepreneurship performance in the Russian Federation, which included its geographical peculiarities, has revealed that monetary control tools, chiefly credit tools and insurance market tools, are still unavailable for this segment of the economy. The authors associate further development of small business in Russia with need for additions to forms of its state backing by means of:

- development of guarantee programs of financing backing of regional small enterprises including credit organizations, herewith the authors favor an idea of establishment the Agency of Loan Guarantees for Small Business at the federal level;
- greater access of small entrepreneurship entities to public contracts; it is necessary to fix a proportion of subcontracting for small business in contracts of large enterprises which have received public contracts;
- establishment of an institute of mutual guarantee controlled by the government and jointly financed by the government and financial institution: commercial banks, insurance organizations, and investment funds;
- extension of the range of industry-specific small business development programs by means of federal and regional budgets.

It is the authors' opinion that these said measures will promote the development of small

business in Russia.

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