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## **Modernization of Institutional Environment of Entrepreneurship in Russia for Development of Innovation Initiative in Small Business Structures**

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**Abstract:**

*This article explores the structure of institutional environment of entrepreneurship in Russia and its influence on the development of small business structures that are involved in innovations. It sets out structural elements of institutional environment: institutions, instruments, and methods of regulation; besides, it defines main criteria of evaluation of the level of development in the sphere of innovative entrepreneurship. In order to improve innovative initiative of small business-structures, the article offers the mechanisms of improvement of institutional entrepreneurial environment.*

**Key Words:** *Institutional Environment, Small Business Structures, Innovational Development*

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**JEL Classification :**

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## **1. Introduction**

Small business structures in economic process of reproduction are one of the main elements of sustainable innovational development, as they are the most dynamic and ensure national competitiveness and economic growth in long-term perspective. Substantiation of the main role of small business structures in the developed and developing countries is obvious, as they are the ones that create around 80% of jobs, and their contribution into formation of GDP constitutes 50%-80% (Report, 2015). Besides, their significance in development of new technologies is obvious – due to economic and social specifics and business qualities.

Modern unstable state of the system of small business in Russia is caused primarily by imperfection of mechanisms of its development management. In particular, there is no system of cooperation of small business structures with subjects of large and medium business, due to which small innovational enterprises exist separately from enterprises of large and medium business – though the technologies they create are aimed for implementation in their production. At present, Russian economy goes through the period of adaptation to new socio-economic conditions of functioning and realia of current processes of globalization of the world economy; moreover, these conditions can significantly change under the influence of many external economic and political forces. Modern Russia faces serious economic conditions: ruble depreciation, the Central Bank key interest rate, economic sanctions, and limited access to foreign markets of loans and credits, which is a serious challenge for various types of modern business structures in Russia.

Results of the conducted research of subjects of small and medium business show that most of existing small enterprises – legal entities (85.9%) – are micro-companies with up to 15 employees. These small companies provide a third part of jobs and 43% of revenue of the sector of small and medium business. Sectorial structure of the sector of small and medium business, as of year-end 2014, consists in the following: most of small and medium enterprises are involved in trade, transport vehicles service, and household goods service (38%), operations in the sphere of real estate and services (21%), construction (11%), minerals extraction, production and distribution of electrical energy, gas, and water (11%). Individual entrepreneurs work primarily in the sphere of trade, transport vehicles service and household goods service, service sphere, and agriculture. More than half of individual entrepreneurs (53%) are involved in wholesale and retail, transport vehicles service and household goods service, 11% – transport, 11% - real estate operations and service sphere, and 7% - agriculture and forestry. Recently, there has appeared a lot of enterprises which conduct their activities in the sphere of R&D

work and production of high-tech and science-intensive products, but still priority in small business remains with companies of trade and service sphere – 25%, real estate operations – 21%, production and distribution of utilities (water, gas, electricity), minerals extraction – 19%, construction companies, agricultural enterprises – 7% (Federal State Statistics Service, 2014).

This statistics shows that development of small business structures in Russia is peculiar for their low inclination for innovations, while there are a lot of small companies in innovational sector in the world. Modern tendencies of development of innovational activities of small business structures in the Russian economy do not fully correspond to expectations which would stipulate the formation of economy of innovational type, absence of tools and institutions of support which provide and stimulate innovational development of small business, imperfection of state regulation and management – all of this shows the necessity for creation of reliable institutional basis (order) of business environment, aggregated with changes in economy, based on leading regional and international experience.

The structure of functioning of small business in innovational sphere, established by the laws of Russia, emerged as a result of influence of existing institutional environment (Fig.1). Institutional environment includes institutes with limitations which structure human relations (North, 1990), including formal and informal rules of behavior. Formal rules include laws and state regulation of business activities. Informal rules include traditions, norms, and culture (Peng, 2003).

Institutes are a system of rule which have to regulate quantitatively determined totality of public relations in existing institutional environment. Institutes create economically and (or) socially effective order of conduct of business activities and are means for its implementation and limitation. Within this research, institute is a system of rules which stipulates creation of sustainable and reproductive social relations which structure business activities. Institutes are diverse and complicated; development of innovational initiative of small business structures requires presence of basic institutes which regulate and stimulate innovational activity (development institutes, financial organizations, venture funds, centers for cooperation of business and which conduct R&D works, etc.).

Study of the structure of innovational business environment can be divided into three stages. First stage includes analysis of fundamental institutes which form institutional environment, in which business structures conduct entrepreneurial activities; second stage includes determination of specific elements of institutional infrastructure, necessary for development and implementation of business initiative and implementation of innovations; third stage includes analysis of informal

institutes and informal societies which form institutional environment, in which the studied economic processes take place.

Structure of institutional environment of business activities is ordered totality of institutes, on the basis of which formal rules and norms develop and the system is in constant motion: rule appear, develop, are supplemented by new rules, disappear, transform from informal to formal ones, and are supplemented by new sanctions. Structure of institutional environment reflects interconnections of structural elements, and central role pressure is put on subject and institutional structure of members (Fig.1) (Epifanova, 2014).

Subject and institutional structure of members (Fig.1) of business activities, depending on their role and influence on conducted business activities by small business structures, can be classified in the following way: main members of business activities; constant and strategic partners of main members of business activities; financial institutes; organizations which satisfy local needs of small and medium enterprises; corporate associations of small and medium enterprises; organizational structures which conduct regulation and control for business activities, organizational structures which protect entrepreneurs' rights.

In Russia, a large role belongs to informal societies which function outside of institutes and involve and integrate individuals which are ready to neglect moral and legal rules. Informal societies are interconnected to formal institutes or work in parallel direction, thus pursuing their own goals. The examples of this are corruption societies, shade structures, and quasi-civilian organizations. Informal societies negatively influence the creation and development of competitive environment in the sphere of small business, including innovational. One of the most important characteristics of institutional environment of business is regulatory aspect which includes external processes which directly influence the sustainable innovational development of enterprises of small and medium business. The basis of regulatory aspect consists of legal mechanisms of realization of administrative, economic, and innovational methods of state regulation, shown in Table 1.

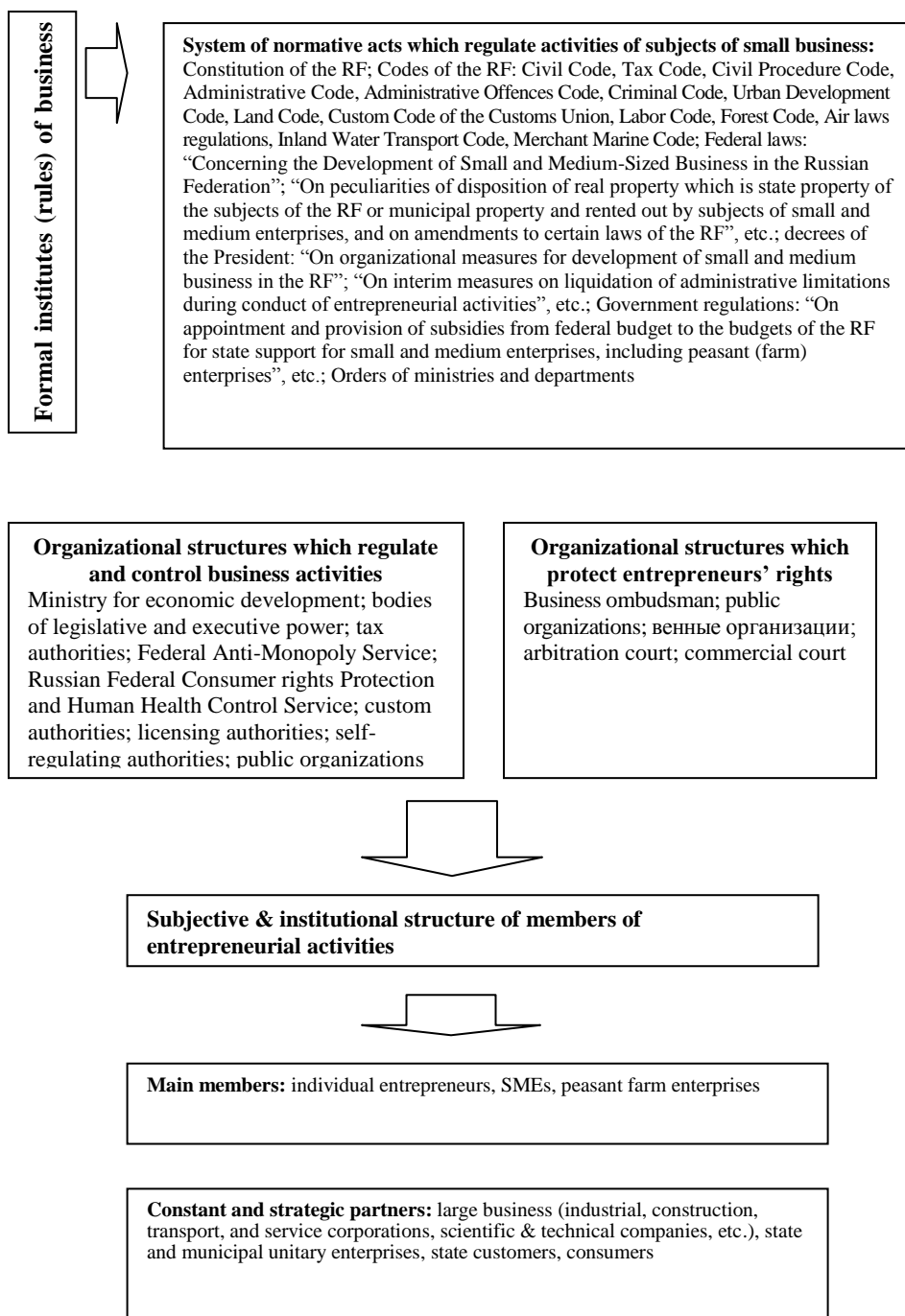
**Table 1. Methods of state regulation**

Administrative methods of state regulation	<ul style="list-style-type: none"><li>• state control for activities of SME;</li><li>• state registration of legal entities and individual entrepreneurs;</li><li>• SME taxation;</li><li>• licensing of particular types of business activities;</li><li>• control for monopolistic markets;</li><li>• establishment of minimal level of income and social</li></ul>
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	<p>benefits;</p> <ul style="list-style-type: none"> <li>• establishment of tariffs.</li> </ul>
Economic methods of state regulation	<ul style="list-style-type: none"> <li>• money &amp; credit and budget policy;</li> <li>• forecasting and programming of socio-economic development;</li> <li>• foreign economic policy;</li> <li>• custom regulation;</li> <li>• state (municipal) order;</li> <li>• state support for investment activities and protection of investors;</li> <li>• state support for subjects of business activities.</li> </ul>
Innovational methods of state regulation	<ul style="list-style-type: none"> <li>• creation and development of competitive markets</li> <li>• demonopolization of economy;</li> <li>• reduction of expenses for tax liabilities;</li> <li>• support for creation of new companies and new types of business based on innovations</li> <li>• provision of macro-economic stability;</li> <li>• development of financial institutes;</li> <li>• development of financial markets and other institutes which ensure transformation of savings into capital;</li> </ul>

Figure 1. Structure of Institutional Environment of Small and Medium Entrepreneurship in Russia

<div style="border: 1px solid black; padding: 5px; display: inline-block; transform: rotate(-90deg); transform-origin: left top;"> <b>Formal institutes (rules) of business</b> </div> 	<b>Regulatory aspect</b>	
	<b>Administrative methods</b>	<b>Economic methods</b>
	<p>State control for activities of SME.</p> <p>State registration of legal entities and individual entrepreneurs.</p> <p>SME taxation.</p> <p>Licensing of particular types of business activities.</p> <p>Control for monopolistic markets.</p> <p>Establishment of minimal level of income and social benefits.</p> <p>Establishment of tariffs.</p>	<p>Money &amp; credit and budget policy.</p> <p>Forecasting and programming of socio-economic development.</p> <p>Foreign economic policy.</p> <p>Custom regulation.</p> <p>State (municipal) order.</p> <p>State support for investment activities and protection of investors.</p> <p>State support for subjects of business activities.</p>



**Financial institutes:** commercial banks, insurance companies, investment companies, leasing companies, non-government pension funds, intermediaries at stock market

**Organizations which satisfy local needs of SMEs:** consulting companies, audit firms, law agencies, software developers, security agencies, advertising, etc.



**Cognitive aspect:** presence of qualification and knowledge for doing business and their accessibility

**Corporate associations of SMEs:**

- regional integration (association and unities of specific region or regions);
- entrepreneurs' belonging to certain social group (youth associations, veteran associations, women associations, etc.);
- sectorial integration (association of international transporters, construction companies)

## 2. Methods

Administrative methods include means of direct power influence on subjects of small and medium business. Economic methods are economic means of influence on business relations with the help of conditions which influence motivation of behavior of subjects of small and medium business. These methods do not limit and do not forbid business activities, but stimulate a businessman to expand or modernize his business, and sometimes – close it, under the economic conditions that change under the state's influence.

Innovational methods of state regulation are based on state programs and program-targeted management, aimed at final result. New program documents include main tasks of the state, oriented at formation of innovational institutional business environment. State policy in the sphere of development of innovational institutional environment is implemented in the following directions (The Forecast, 2013):

- creation of favorable economic and legal environment as to innovational activities;

- formation of innovational system infrastructure;
- creation of the system of state support for commercialization of results of intellectual activities.

Main mechanisms of realization of state policy in the sphere of innovational system development include:

- formation of comprehensive system of organizational & legal, economic, and other norms of stimulation, support, and regulation of innovational activities, including establishment of the order of acquisition and transfer of rights for the results of intellectual activities of civilian and double purpose, created by means of assets of federal budget, for the purpose of their implementation into economic turnover; perfection of legal base for development of venture business;
- transfer to program-targeted principle of state support of innovational activities through coordination of federal, regional, interdepartmental, and departmental targeted programs, including support for innovational activities in academies of sciences with national status, national scientific centers of the Russian Federation, and higher educational establishments;
- increase of the share of non-budget resources with completion of stages of innovational projects, including creation of institutes of financing of high-tech enterprises at initial stage of creation of innovational products; support for formation of the system of regional and sectorial venture funds;
- development of internal market of innovational products;
- attraction of organizations of small and medium enterprises for participation in targeted programs and innovational projects;
- formation with entrepreneurs of motivation for development of innovational activities, including by means of expansion of programs, financed by the state;
- state's participation in development of infrastructure of innovational system;
- development of criteria of selection of priorities of state policy in the sphere of development of innovational system and determination at the stage of R&D works of potential possibilities for manufacture of competitive innovational products.

Thus, the state influences business activities of subjects of small business for the purpose of provision of realization of public interests of society and state, including creation of conditions for development of business on the whole. State support for



small and medium business is a dominant of state regulation. Necessity and expediency of such support are determined by peculiarities of the sphere of small and medium business, which consist in its innovational potential, social functions, and demonopolization of economy.

State support, which determined quantitative state of institutional environment, is connection between economic, legal, and administrative relations of state and business subjects. These relations are aimed at activization of all forms of business initiative, the main goal of which is gaining maximum profit for society on the whole.

Significant influence on development of institutional environment of business is conducted by tax, price, anti-monopoly, anti-dumping, and competitive policy of the state. Optimal taxation system influences effective development of production. On the one hand, taxation system should stipulate the inflow of sufficient volume of assets into the state's budget, and, on the other hand, should not be a heavy load for subjects of small and medium business during conduct of business activities. A range of events for changing tax load on subjects of small business, held in 2012-2014, negatively influenced their development. In particular, increase of insurance payments, canceling of subsidy for property tax for payers of special tax regimes led to reduction of small business sector by 12.7%, to the level of 2007 (Report, 2015).

Provision of healthy competition at various segments of the market occupies an important place in creation of favorable institutional environment of business. Main task of the state in this issue is provision of equal initial conditions for development of various companies, prevention of criminalization of business environment, and reduction of risk of social instability. These conditions could be created with the help of a special system of financing, crediting, and insurance of small enterprises. This system will allow ensuring equal access to financial resources of state and local budgets and to assets of commercial financial & credit structures, which will allow preserving sustainable functioning of enterprises at initial stage of work and protecting potential investors from possible financial losses.

Undoubtedly, pricing plays a very important role. At present, there is not such state policy, which leads to excessive growth of cost of such indicators as utility fees, rental fees, fuel, etc., which leads to growth of inflation and prices for all types of goods and services.

A defining element of institutional business environment is the system of existing legal regulation, which determines legally established rules of business activities:

– forming necessary preconditions for business activities;

- ensuring the right for conducting business activities with corresponding guarantees;
- determining the sense, conditions, and order of business activities;
- fixing criteria of belonging of specific territories to the category of business-structures;
- determining structure of state bodies which are responsible for development of small business;
- fixing forms and ways of state support for small business, including long-term and short-term targeted programs for supporting the sphere of business activities.

A very important role for adequate institutional environment of business belongs to cognitive aspect, which is characterized by presence of qualification and knowledge for conduct of business. Probability of starting own business growth with the level of entrepreneur's evaluation of his knowledge and skills and his inclination for risk (GEM, 2013). Level of development of business culture is influenced by many factors:

- general economic conditions of region's development;
- historical experience;
- education.

General attitude of population towards business significantly influences the level of development of business on the whole. Level of development of entrepreneurial activity in the country grows with the quantity of people who wish to start their own business. Lack of entrepreneurial activity is a significant obstacle for achievement of economic growth and development of innovational economy.

It should be noted that institutional environment of business in the Russian Federation differs a lot from conditions of doing business in developed countries – from the point of view of changes therein and unpredictability. Determination of key factors of institutional business environment, which influence sustainability of development of enterprises of small business, has theoretical and practical significance.

Vienna Institute of Management distinguished 10 basic indicators for evaluation of the level of development of institutional environment (Weforum, 2015): legal environment and regulation; adaptability of state policy to economic shocks;

transparency of state policy; effectiveness of bureaucracy, reflecting its influence on business activities; effectiveness of fulfillment of government's decisions; effectiveness of laws on competition for prevention of unfair competition; level of corruption and bribery; fulfillment of laws; simplicity of doing business and support for business at legislative level; safety of personality and protection of ownership right. Development of institutional business environment in the sphere of innovational business, on the one hand, obeys the general regularities of development of institutional environment, and, on the other hand, has its specifics. In our opinion, for the purpose of evaluation of the level of development of business environment, the following aspects – together with the above indicators – should be studied: level of R&D activity; real accessibility of financing of innovational projects at early stages; level of legal basis of investor's activities; level of intellectual property protection; accessibility of technological infrastructure; presence of territorial innovational systems (of national, regional, and local level); real access to objects of infrastructure of support for small innovational companies; level of dependence on import of technologies and services.

### **3. Conclusion**

At present, the level of development of innovational business in Russia is rather low. It is possible to state the absence of properly formed institutional environment for development of small business in innovational sphere. For the purpose of increase of innovational initiative of small business structures and perfection of institutional environment of business, the following is offered:

- 1) in order to determine the level of development of institutional environment of business in Russia, perform evaluation of its state with the use of the above indicators, and, based on the results of monitoring, take quick measures for its improvement;
- 2) it is advisable to create and ensure universal institutional order of doing business by small business structures, as a mechanism for reduction of influence of informal associations. Universalization of institutional order is the state's function, which, through realization of its power authorities, should objectively guarantee single legal environment for all subjects of entrepreneurial activities, through formation of efficient institutes and tools, determines and implements common innovational strategy;
- 3) for improvement of institutional environment of business, implementation of the following innovational institutes and tools is offered:

- implementation of the register of innovational small business structures, for determination of their innovational potential (on the basis of common state register of legal entities and individual entrepreneurs);
- creation of centers for coordination and cooperation of business, for the purpose of involvement of small business structures into innovational clusters;
- development of public private partnership;
- implementation of innovational financial & economic tools (investment bonuses for small business structures; refinancing of loans; provision of tax subsidies for innovational business structures during implementation of production and technological innovations; provision of interest free tender loans for participation in state contract for manufacture of innovational products).

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